99th Congress
2d Session

HOUSE OF REPRESENTATIVES

Report
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TAX REFORM ACT OF 1986

CONFERENCE REPORT

TO ACCOMPANY

H.R. 3838

Volume I of 2 Volumes

SEPTEMBER 18, 1986.—Ordered to be printed

Y1.1/8:

99th Congress
2d Session

HOUSE OF REPRESENTATIVES

Report
99-841

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September 18, 1986.—Ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
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JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 3838) to reform the internal revenue laws of the United States, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck out all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment which is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary for agreements reached by the conferees, and minor drafting and clarifying changes.

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99TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
99-841

TAX REFORM ACT OF 1986

SEPTEMBER 18, 1986.—Ordered to be printed

Mr. ROSTENKOWSKI, from the committee of conference,
submitted the following

CONFERENCE REPORT

[To accompany H.R. 3838]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 3838) to reform the internal revenue laws of the United States, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Tax Reform Act of 1986".

(b) TABLE OF CONTENTS.—

TITLE I—INDIVIDUAL INCOME TAX PROVISIONS

Subtitle A—Rate Reductions; Increase in Standard Deduction and Personal Exemptions

Sec. 101. Rate reductions.
Sec. 102. Increase in standard deduction.
Sec. 103. Increase in personal exemptions.
Sec. 104. Technical amendments.

Subtitle B—Provisions Related to Tax Credits

Sec. 111. Increase in earned income credit.
Sec. 112. Repeal of credit for contributions to candidates for public office.

Subtitle C—Provisions Related to Exclusions

Sec. 121. Taxation of unemployment compensation.
Sec. 122. Prizes and awards.
Sec. 123. Scholarships.

Subtitle D—Provisions Related to Deductions

Sec. 131. Repeal of deduction for 2-earner married couples.
Sec. 132. 2-percent floor on miscellaneous itemized deductions.
Sec. 133. Medical expense deduction limitation increased.
Sec. 134. Repeal of deduction for State and local sales tax.
Sec. 135. Repeal of deduction for adoption expenses.

Subtitle E—Miscellaneous Provisions

Sec. 141. Repeal of income averaging.
Sec. 142. Limitations on deductions for meals, travel, and entertainment.
Sec. 143. Changes in treatment of hobby loss, etc.
Sec. 144. Deduction for mortgage interest and real property taxes allowable where parsonage allowance or military housing allowance received.

Subtitle F—Effective Dates

Sec. 151. Effective dates.

TITLE II—PROVISIONS RELATING TO CAPITAL COST

Subtitle A—Depreciation Provisions

Sec. 201. Modification of accelerated cost recovery system.
Sec. 202. Expensing of depreciable assets.
Sec. 203. Effective dates; general transitional rules.

Subtitle B—Repeal of Regular Investment Tax Credit

Sec. 211. Repeal of regular investment tax credit.
Sec. 212. Effective 15-year carryback of existing carryforwards of steel companies.
Sec. 213. Effective 15-year carryback of existing carryforwards of qualified farmers.

Subtitle C—General Business Credit Reduction

Sec. 221. Reduction in tax liability which may be offset by business credit from 85 percent to 75 percent.

Subtitle D—Research and Development Provisions

Sec. 231. Amendments relating to credit for increasing research activities.
Sec. 232. Extension of credit for clinical testing expenses for certain drugs.

Subtitle E—Changes in Certain Amortization Provisions

Sec. 241. Repeal of 5-year amortization of trademark and trade name expenditures.
Sec. 242. Repeal of amortization of railroad grading and tunnel bores.
Sec. 243. Deduction for bus and freight forwarder operating authority.
Sec. 244. Treatment of expenditures for removal of architectural barriers to the handicapped and elderly made permanent.

Subtitle F—Provisions Relating to Real Estate

Sec. 251. Modification of investment tax credit for rehabilitation expenditures.
Sec. 252. Low-income housing credit.

Subtitle G—Merchant Marine Capital Construction Funds

Sec. 261. Provisions relating to merchant marine capital construction funds.

TITLE III—CAPITAL GAINS

Subtitle A—Individual Capital Gains

Sec. 301. Repeal of exclusion for long-term capital gains of individuals.
Sec. 302. 28-percent capital gains rate for taxpayers other than corporations.

Subtitle B—Repeal of Corporate Capital Gains Treatment

Sec. 311. Repeal of corporate capital gains treatment.

Subtitle C—Incentive Stock Options

Sec. 321. Repeal of requirement that incentive stock options are exercisable only in chronological order; modification of $100,000 limitation.

Subtitle D—Straddles

Sec. 331. Year-end rule expanded.

TITLE IV—AGRICULTURE, ENERGY, AND NATURAL RESOURCES

Subtitle A—Agriculture

Sec. 401. Limitation on expensing of soil and water conservation expenditures.
Sec. 402. Repeal of special treatment for expenditures for clearing land.
Sec. 403. Treatment of dispositions of converted wetlands or highly erodible croplands.
Sec. 404. Limitation on certain prepaid farming expenses.
Sec. 405. Tax treatment of discharge of certain indebtedness of solvent farmers.

Subtitle B—Treatment of Oil, Gas, Geothermal, and Hard Minerals

Sec. 411. Treatment of intangible drilling costs and mineral exploration and development costs.
Sec. 412. Modification of percentage depletion rules.
Sec. 413. Gain from disposition of interests in oil, gas, geothermal, or other mineral properties.

Subtitle C—Other Provisions

Sec. 421. Extension of energy investment credit for solar, geothermal, ocean thermal, and biomass property.
Sec. 422. Provisions relating to excise tax on fuels.
Sec. 423. Ethyl alcohol and mixtures thereof for fuel use.

TITLE V—TAX SHELTER LIMITATIONS; INTEREST LIMITATIONS

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SEC. 2. INTERNAL REVENUE CODE OF 1986.

(a) REDESIGNATION OF 1954 CODE.—The Internal Revenue Title enacted August 16, 1954, as heretofore, hereby, or hereafter amended, may be cited as the "Internal Revenue Code of 1986".

(b) REFERENCES IN LAWS, ETC.—Except when inappropriate, any reference in any law, Executive order, or other document—

(1) to the Internal Revenue Code of 1954 shall include a reference to the Internal Revenue Code of 1986, and

(2) to the Internal Revenue Code of 1986 shall include a reference to the provisions of law formerly known as the Internal Revenue Code of 1954.

SEC. 3. AMENDMENT OF 1986 CODE; COORDINATION WITH SECTION 15.

(a) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(b) COORDINATION WITH SECTION 15.—

(1) IN GENERAL.—Except as provided in paragraph (2), for purposes of section 15 of the Internal Revenue Code of 1986, no amendment or repeal made by this Act shall be treated as a change in the rate of a tax imposed by chapter 1 of such Code.

(2) EXCEPTION.—Paragraph (1) shall not apply to the amendment made by section 601 (relating to corporate rate reductions).

TITLE I—INDIVIDUAL INCOME TAX PROVISIONS

Subtitle A—Rate Reductions; Increase in Standard Deduction and Personal Exemptions

SEC. 101. RATE REDUCTIONS.

(a) GENERAL RULE.—Section 1 (relating to tax imposed on individuals) is amended to read as follows:

"SECTION 1. TAX IMPOSED.

"(a) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—There is hereby imposed on the taxable income of—

"(1) every married individual (as defined in section 7703) who makes a single return jointly with his spouse under section 6013, and

"(2) every surviving spouse (as defined in section 2(a)),

a tax determined in accordance with the following table:

“If taxable income is	The tax is:
Not over $29,750	15% of taxable income.
Over $29,750	$4,462.50, plus 28% of the excess over $29,750.

“(b) Heads of Households.—There is hereby imposed on the taxable income of every head of a household (as defined in section 2(b)) a tax determined in accordance with the following table:

“If taxable income is	The tax is:
Not over $23,900	15% of taxable income.
Over $23,900	$3,585, plus 28% of the excess over $23,900.

“(c) Unmarried Individuals (Other Than Surviving Spouses and Heads of Households).—There is hereby imposed on the taxable income of every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703) a tax determined in accordance with the following table:

“If taxable income is	The tax is:
Not over $17,850	15% of taxable income.
Over $17,850	$2,677.50, plus 28% of the excess over $17,850.

“(d) Married Individuals Filing Separate Returns.—There is hereby imposed on the taxable income of every married individual (as defined in section 7703) who does not make a single return jointly with his spouse under section 6013, a tax determined in accordance with the following table:

“If taxable income is	The tax is:
Not over $14,875	15% of taxable income.
Over $14,875	$2,231.25, plus 28% of the excess over $14,875.

“(e) Estates and Trusts.—There is hereby imposed on the taxable income of—

“(1) every estate, and

“(2) every trust,

taxable under this subsection a tax determined in accordance with the following table:

“If taxable income is	The tax is:
Not over $5,000	15% of taxable income.
Over $5,000	$750, plus 28% of the excess over $5,000.

“(f) Adjustments in Tax Tables so That Inflation Will Not Result in Tax Increases.—

“(1) In general.—Not later than December 15 of 1988, and each subsequent calendar year, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in subsections (a), (b), (c), (d), and (e) with respect to taxable years beginning in the succeeding calendar year.

“(2) Method of prescribing tables.—The table which under paragraph (1) is to apply in lieu of the table contained in subsection (a), (b), (c), (d), or (e), as the case may be, with respect to taxable years beginning in any calendar year shall be prescribed—

“(A) by increasing the minimum and maximum dollar amounts for each rate bracket for which a tax is imposed *under such table by the cost-of-living adjustment for such calendar year,*

"(B) by not changing the rate applicable to any rate bracket as adjusted under subparagraph (A), and

"(C) by adjusting the amounts setting forth the tax to the extent necessary to reflect the adjustments in the rate brackets.

"(3) COST-OF-LIVING ADJUSTMENT.—For purposes of paragraph (2), the cost-of-living adjustment for any calendar year is the percentage (if any) by which—

"(A) the CPI for the preceding calendar year, exceeds

"(B) the CPI for the calendar year 1987.

"(4) CPI FOR ANY CALENDAR YEAR.—For purposes of paragraph (3), the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on August 31 of such calendar year.

"(5) CONSUMER PRICE INDEX.—For purposes of paragraph (4), the term 'Consumer Price Index' means the last Consumer Price Index for all-urban consumers published by the Department of Labor. For purposes of the preceding sentence, the revision of the Consumer Price Index which is most consistent with the Consumer Price Index for calendar year 1986 shall be used.

"(6) ROUNDING.—

"(A) IN GENERAL.—If any increase determined under paragraph (2)(A), subsection (g)(4), section 63(c)(4), or section 151(d)(3) is not a multiple of $50, such increase shall be rounded to the next lowest multiple of $50.

"(B) TABLE FOR MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a married individual filing a separate return, subparagraph (A) (other than with respect to section 63(c)(4)) shall be applied by substituting '$25' for '$50' each place it appears.

"(g) PHASEOUT OF 15-PERCENT RATE AND PERSONAL EXEMPTIONS.—

"(1) IN GENERAL.—The amount of tax imposed by this section (determined without regard to this subsection) shall be increased by 5 percent of the excess (if any) of—

"(A) taxable income, over

"(B) the applicable dollar amount.

"(2) LIMITATION.—The increase determined under paragraph (1) with respect to any taxpayer for any taxable year shall not exceed the sum of—

"(A) 13 percent of the maximum amount of taxable income to which the 15-percent rate applies under the table contained in subsection (a), (b), (c), or (e) (whichever applies), and

"(B) 28 percent of the deductions for personal exemptions allowable to the taxpayer for the taxable year under section 151.

In the case of any individual taxable under subsection (d), subparagraph (A) shall apply as if such individual were taxable under subsection (a).

"(3) APPLICABLE DOLLAR AMOUNT.—For purposes of paragraph (1), the applicable dollar amount shall be determined under the following table:

"In the case of a taxpayer to which the following subsection of this section applies:	*The applicable dollar amount is:*
Subsection (a)	*$71,900*
Subsection (b)	*61,650*
Subsection (c)	*43,150*
Subsection (d)	*35,950*
Subsection (e)	*13,000*

"(4) ADJUSTMENT FOR INFLATION.—In the case of any taxable year beginning in a calendar year after 1988, each dollar amount contained in paragraph (3) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under subsection (f)(3) for the calendar year in which the taxable year begins.

"(h) TAX SCHEDULES FOR TAXABLE YEARS BEGINNING IN 1987.—In the case of any taxable year beginning in 1987—

"(1) subsection (g) shall not apply, and

"(2) the following tables shall apply in lieu of the tables set forth in subsections (a), (b), (c), (d), and (e):

"(A) MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES.—The table to apply for purposes of subsection (a) is as follows:

"If taxable income is	*The tax is:*
Not over $3,000	*11% of taxable income.*
Over $3,000 but not over $28,000	*$330, plus 15% of the excess over $3,000.*
Over $28,000 but not over $45,000	*$4,080, plus 28% of the excess over $28,000.*
Over $45,000 but not over $90,000	*$8,840, plus 35% of the excess over $45,000.*
Over $90,000	*$24,590, plus 38.5% of the excess over $90,000.*

"(B) HEADS OF HOUSEHOLDS.—The table to apply for purposes of subsection (b) is as follows:

"If taxable income is	*The tax is:*
Not over $2,500	*11% of taxable income.*
Over $2,500 but not over $23,000	*$275, plus 15% of the excess over $2,500.*
Over $23,000 but not over $38,000	*$3,350, plus 28% of the excess over $23,000.*
Over $38,000 but not over $80,000	*$7,550, plus 35% of the excess over $38,000.*
Over $80,000	*$22,250, plus 38.5% of the excess over $80,000.*

"(C) UNMARRIED INDIVIDUALS OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS.—The table to apply for purposes of subsection (c) is as follows:

"If taxable income is	*The tax is:*
Not over $1,800	*11% of taxable income.*
Over $1,800 but not over $16,800	*$198, plus 15% of the excess over $1,800.*

“If taxable income is	*The tax is:*
Over $16,800 but not over $27,000	*$2,448, plus 28% of the excess over $16,800.*
Over $27,000 but not over $54,000	*$5,304, plus 35% of the excess over $27,000.*
Over $54,000	*$14,754, plus 38.5% of the excess over $54,000.*

“(D) Married individuals filing separate returns.—The table to apply for purposes of subsection (d) is as follows:

“If taxable income is	*The tax is:*
Not over $1,500	*11% of taxable income.*
Over $1,500 but not over $14,000	*$165, plus 15% of the excess over $1,500.*
Over $14,000 but not over $22,500	*$2,040, plus 28% of the excess over $14,000.*
Over $22,500 but not over $45,000	*$4,420, plus 35% of the excess over $22,500.*
Over $45,000	*$12,295, plus 38.5% of the excess over $45,000.*

“(E) Estates and trusts.—The table to apply for purposes of subsection (e) is as follows:

“If taxable income is	*The tax is:*
Not over $500	*11% of taxable income.*
Over $500 but not over $4,700	*$55, plus 15% of the excess over $500.*
Over $4,700 but not over $7,550	*$685, plus 28% of the excess over $4,700.*
Over $7,550 but not over $15,150	*$1,483, plus 35% of the excess over $7,500.*
Over $15,150	*$4,143, plus 38.5% of the excess over $15,150.”*

(b) Amendment of Section 15.—Subsection (d) of section 15 (relating to effect of changes in rates during a taxable year) is amended to read as follows:

“(d) Section Not To Apply to Inflation Adjustments.—This section shall not apply to any change in rates under subsection (f) of section 1 (relating to adjustments in tax tables so that inflation will not result in tax increases).”

SEC. 102. INCREASE IN STANDARD DEDUCTION.

(a) General Rule.—Section 63 (defining taxable income) is amended to read as follows:

“SEC. 63. TAXABLE INCOME DEFINED.

“(a) In General.—Except as provided in subsection (b), for purposes of this subtitle, the term ‘taxable income’ means gross income minus the deductions allowed by this chapter (other than the standard deduction).

“(b) Individuals Who Do Not Itemize Their Deductions.—In the case of an individual who does not elect to itemize his deductions for the taxable year, for purposes of this subtitle, the term ‘taxable income’ means adjusted gross income, minus—

“(1) the standard deduction, and

“(2) the deduction for personal exemptions provided in section 151.

“(c) Standard Deduction.—For purposes of this subtitle—

“(1) In general.—Except as otherwise provided in this subsection, the term ‘standard deduction’ means the sum of—

"(A) the basic standard deduction, and

"(B) the additional standard deduction.

"(2) BASIC STANDARD DEDUCTION.—For purposes of paragraph (1), the basic standard deduction is—

"(A) $5,000 in the case of—

"(i) a joint return, or

"(ii) a surviving spouse (as defined in section 2(a)),

"(B) $4,400 in the case of a head of household (as defined in section 2(b)),

"(C) $3,000 in the case of an individual who is not married and who is not a surviving spouse or head of household, or

"(D) $2,500 in the case of a married individual filing a separate return.

"(3) ADDITIONAL STANDARD DEDUCTION FOR AGED AND BLIND.—For purposes of paragraph (1), the additional standard deduction is the sum of each additional amount to which the taxpayer is entitled under subsection (f).

"(4) ADJUSTMENTS FOR INFLATION.—In the case of any taxable year beginning in a calendar year after 1988, each dollar amount contained in paragraph (2) or (5)(A) or subsection (f) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins.

"(5) LIMITATION ON STANDARD DEDUCTION IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the standard deduction applicable to such individual for such individual's taxable year shall not exceed the greater of—

"(A) $500, or

"(B) such individual's earned income.

"(6) CERTAIN INDIVIDUALS, ETC., NOT ELIGIBLE FOR STANDARD DEDUCTION.—In the case of—

"(A) a married individual filing a separate return where either spouse itemizes deductions,

"(B) a nonresident alien individual,

"(C) a citizen of the United States entitled to the benefits of section 931 (relating to income from sources within possessions of the United States),

"(D) an individual making a return under section 443(a)(1) for a period of less than 12 months on account of a change in his annual accounting period, or

"(E) an estate or trust, common trust fund, or partnership,

the standard deduction shall be zero.

"(d) ITEMIZED DEDUCTIONS.—For purposes of this subtitle, the term 'itemized deductions' means the deductions allowable under this chapter other than—

"(1) the deductions allowable in arriving at adjusted gross income, and

"(2) the deduction for personal exemptions provided by section 151.

"(e) Election To Itemize.—

"(1) In general.—Unless an individual makes an election under this subsection for the taxable year, no itemized deduction shall be allowed for the taxable year. For purposes of this subtitle, the determination of whether a deduction is allowable under this chapter shall be made without regard to the preceding sentence.

"(2) Time and manner of election.—Any election under this subsection shall be made on the taxpayer's return, and the Secretary shall prescribe the manner of signifying such election on the return.

"(3) Change of election.—Under regulations prescribed by the Secretary, a change of election with respect to itemized deductions for any taxable year may be made after the filing of the return for such year. If the spouse of the taxpayer filed a separate return for any taxable year corresponding to the taxable year of the taxpayer, the change shall not be allowed unless, in accordance with such regulations—

"(A) the spouse makes a change of election with respect to itemized deductions, for the taxable year covered in such separate return, consistent with the change of treatment sought by the taxpayer, and

"(B) the taxpayer and his spouse consent in writing to the assessment (within such period as may be agreed on with the Secretary) of any deficiency, to the extent attributable to such change of election, even though at the time of the filing of such consent the assessment of such deficiency would otherwise be prevented by the operation of any law or rule of law.

This paragraph shall not apply if the tax liability of the taxpayer's spouse for the taxable year corresponding to the taxable year of the taxpayer has been compromised under section 7122.

"(f) Aged or Blind Additional Amounts.—

"(1) Additional amounts for the aged.—The taxpayer shall be entitled to an additional amount of $600—

"(A) for himself if he has attained age 65 before the close of his taxable year, and

"(B) for the spouse of the taxpayer if the spouse has attained age 65 before the close of the taxable year and an additional exemption is allowable to the taxpayer for such spouse under section 151(b).

"(2) Additional amount for blind.—The taxpayer shall be entitled to an additional amount of $600—

"(A) for himself if he is blind at the close of the taxable year, and

"(B) for the spouse of the taxpayer if the spouse is blind as of the close of the taxable year and an additional exemption is allowable to the taxpayer for such spouse under section 151(b).

For purposes of subparagraph (B), if the spouse dies during the taxable year the determination of whether such spouse is blind shall be made as of the time of such death.

"(3) HIGHER AMOUNT FOR CERTAIN UNMARRIED INDIVIDUALS.—In the case of an individual who is not married and is not a surviving spouse, paragraphs (1) and (2) shall be applied by substituting '$750' for '$600'.

"(4) BLINDNESS DEFINED.—For purposes of this subsection, an individual is blind only if his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or if his visual acuity is greater than 20/200 but is accompanied by a limitation in the fields of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

"(g) MARITAL STATUS.—For purposes of this section, marital status shall be determined under section 7703.

"(h) TRANSITIONAL RULE FOR TAXABLE YEARS BEGINNING IN 1987.—In the case of any taxable year beginning in 1987, paragraph (2) of subsection (c) shall be applied—

"(1) by substituting '$3,760' for '$5,000',

"(2) by substituting '$2,540' for '$4,400',

"(3) by substituting '$2,540' for '$3,000', and

"(4) by substituting '$1,880' for '$2,500'.

The preceding sentence shall not apply if the taxpayer is entitled to an additional amount determined under subsection (f) (relating to additional amount for aged and blind) for the taxable year."

(b) TAX TABLES.—Section 3 (relating to tax tables for individuals) is amended by striking out subsection (a) and inserting in lieu thereof the following:

"(a) IMPOSITION OF TAX TABLE TAX.—

"(1) IN GENERAL.—In lieu of the tax imposed by section 1, there is hereby imposed for each taxable year on the taxable income of every individual—

"(A) who does not itemize his deductions for the taxable year, and

"(B) whose taxable income for such taxable year does not exceed the ceiling amount,

a tax determined under tables, applicable to such taxable year, which shall be prescribed by the Secretary and which shall be in such form as he determines appropriate. In the table so prescribed, the amounts of the tax shall be computed on the basis of the rates prescribed by section 1.

"(2) CEILING AMOUNT DEFINED.—For purposes of paragraph (1), the term 'ceiling amount' means, with respect to any taxpayer, the amount (not less than $20,000) determined by the Secretary for the tax rate category in which such taxpayer falls.

"(3) AUTHORITY TO PRESCRIBE TABLES FOR TAXPAYERS WHO ITEMIZE DEDUCTIONS.—The Secretary may provide that this section shall apply also for any taxable year to individuals who itemize their deductions. Any tables prescribed under the preceding sentence shall be on the basis of taxable income."

SEC. 103. INCREASE IN PERSONAL EXEMPTIONS.

(a) GENERAL RULE.—Subsection (f) of section 151 (defining exemption amount) is amended to read as follows:

"(f) EXEMPTION AMOUNT.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (2), the term 'exemption amount' means—

"(A) $1,900 for taxable years beginning during 1987,

"(B) $1,950 for taxable years beginning during 1988, and

"(C) $2,000 for taxable years beginning after December 31, 1988.

"(2) EXEMPTION AMOUNT DISALLOWED IN THE CASE OF CERTAIN DEPENDENTS.—In the case of an individual with respect to whom a deduction under this section is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins, the exemption amount applicable to such individual for such individual's taxable year shall be zero.

"(3) INFLATION ADJUSTMENT FOR YEARS AFTER 1989.—In the case of any taxable year beginning in a calendar year after 1989, the dollar amount contained in paragraph (1)(C) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3), for the calendar year in which the taxable year begins, by substituting 'calendar year 1988' for 'calendar year 1987' in subparagraph (B) thereof."

(b) REPEAL OF ADDITIONAL EXEMPTIONS FOR TAXPAYERS OVER AGE 65 OR BLIND.—Section 151 is amended by striking out subsections (c) and (d) and by redesignating subsections (e) and (f) as subsections (c) and (d), respectively.

SEC. 104. TECHNICAL AMENDMENTS.

(a) FILING REQUIREMENTS.—

(1) SECTION 6012.—

(A) Paragraph (1) of section 6012(a) (relating to persons required to make returns of income) is amended to read as follows:

"(1)(A) Every individual having for the taxable year gross income which equals or exceeds the exemption amount, except that a return shall not be required of an individual—

"(i) who is not married (determined by applying section 7703), is not a surviving spouse (as defined in section 2(a)), is not a head of a household (as defined in section 2(b)), and for the taxable year has gross income of less than the sum of the exemption amount plus the basic standard deduction applicable to such an individual,

"(ii) who is a head of a household (as so defined) and for the taxable year has gross income of less than the sum of the exemption amount plus the basic standard deduction applicable to such an individual,

"(iii) who is a surviving spouse (as so defined) and for the taxable year has gross income of less than the sum of the exemption amount plus the basic standard deduction applicable to such an individual, or

"(iv) who is entitled to make a joint return and whose gross income, when combined with the gross income of his spouse, is, for the taxable year, less than the sum of twice the exemption amount plus the basic standard deduction applicable to a joint return, but only if such individual

and his spouse, at the close of the taxable year, had the same household as their home.

Clause (iv) shall not apply if for the taxable year such spouse makes a separate return or any other taxpayer is entitled to an exemption for such spouse under section 151(c).

"(B) The amount specified in clause (i), (ii), or (iii) of subparagraph (A) shall be increased by the amount of 1 additional standard deduction (within the meaning of section 63(c)(3)) in the case of an individual entitled to such deduction by reason of section 63(f)(1)(A) (relating to individuals age 65 or more), and the amount specified in clause (iv) of subparagraph (A) shall be increased by the amount of the additional standard deduction for each additional standard deduction to which the individual or his spouse is entitled by reason of section 63(f)(1).

"(C) The exception under subparagraph (A) shall not apply to any individual—

"(i) who is described in section 63(c)(5) and who has—

"(I) income (other than earned income) in excess of the amount in effect under section 63(c)(5)(A) (relating to limitation on standard deduction in the case of certain dependents), or

"(II) total gross income in excess of the standard deduction, or

"(ii) for whom the standard deduction is zero under section 63(c)(6).

"(D) For purposes of this subsection—

"(i) The terms 'standard deduction', 'basic standard deduction' and 'additional standard deduction' have the respective meanings given such terms by section 63(c).

"(ii) The term 'exemption amount' has the meaning given such term by section 151(d). In the case of an individual described in section 151(d)(2), the exemption amount shall be zero."

(B) Paragraph (9) of section 6012(a) is amended by striking out "$2,700 or more" and inserting in lieu thereof "not less than the sum of the exemption amount plus the basic standard deduction under section 63(c)(2)(D)".

(2) Section 6013.—Subparagraph (A) of section 6013(b)(3) (relating to when return deemed filed) is amended—

(A) by striking out "(twice the exemption amount in case such spouse was 65 or over)" each place it appears,

(B) by striking out "section 151(f)" and inserting in lieu thereof "section 151(d)", and

(C) by adding at the end thereof the following new sentence: "For purposes of clauses (ii) and (iii), if the spouse whose gross income is being compared to the exemption amount is 65 or over, such clauses shall be applied by substituting 'the sum of the exemption amount and the additional standard deduction under section 63(c)(2) by reason of section 63(f)(1)(A)' for 'the exemption amount'."

(b) Other Amendments.—

(1) Section 21, etc.—

(A) Sections 21(b)(1)(A), 21(e)(6)(A), and 129(c)(1) are each amended by striking out "section 151(e)" and inserting in lieu thereof "section 151(c)".

(B) Sections 21(e)(6)(B), 32(c)(1)(A)(i), 129(c)(2), and 152(e)(1)(A) are each amended by striking out "section 151(e)(3)" and inserting in lieu thereof "section 151(c)(3)".

(2) Section 108.—Subparagraph (B) of section 108(b)(3) is amended by striking out "50 cents" and inserting in lieu thereof "33⅓ cents".

(3) Section 152, etc.—Sections 152(d)(2) and 2032A(c)(7)(D) are each amended by striking out "section 151(e)(4)" and inserting in lieu thereof "section 151(c)(4)".

(4) Section 172.—Subsection (d) of section 172 (relating to modifications) is amended by striking out paragraph (7).

(5) Section 402.—Subparagraph (B) of section 402(e)(1), as amended by section 1222(b), is amended by striking out "the zero bracket amount applicable to such individual for the taxable year plus".

(6) Section 441.—Clause (iii) of section 441(f)(2)(B) (relating to change in accounting period) is amended by striking out "and by adding the zero bracket amount,".

(7) Section 443.—

(A) Paragraph (1) of section 443(b) (relating to computation of tax on change of annual accounting period) is amended by striking out ", and adding the zero bracket amount".

(B) Clause (ii) of section 443(b)(2)(A) (relating to computation based on 12-month period) is amended to read as follows:

"(ii) the tax computed on the modified taxable income for the short period."

(8) Section 541.—Section 541 is amended by striking out "50 percent" and inserting in lieu thereof "28 percent (38.5 percent in the case of taxable years beginning in 1987)".

(9) Section 613A.—Paragraph (1) of section 613A(d) (relating to limitation on percentage depletion based on taxable income) is amended by striking out "(reduced in the case of an individual by the zero bracket amount)".

(10) Section 667.—Paragraph (2) of section 667(b) (relating to tax on amount deemed distributed by trust in preceding years) is amended to read as follows:

"(2) Treatment of loss years.—For purposes of paragraph (1), the taxable income of the beneficiary for any taxable year shall be deemed to be not less than zero."

(11) Section 861.—Subsection (b) of section 861 (relating to taxable income from sources within the United States) is amended by striking out "the zero bracket amount" and inserting in lieu thereof "the standard deduction".

(12) Section 862.—Subsection (b) of section 862 (relating to taxable income from sources without the United States) is amended by striking out "the zero bracket amount" and inserting in lieu thereof "the standard deduction".

(13) SECTION 904.—Subsection (a) of section 904 (relating to limitation on foreign tax credit) is amended by striking out the last sentence.

(14) SECTION 1398.—Subsection (c) of section 1398 (relating to computation and payment of tax; zero bracket amount) is amended—

(A) by striking out "ZERO BRACKET AMOUNT" in the subsection heading and inserting in lieu thereof "BASIC STANDARD DEDUCTION", and

(B) by striking out paragraph (3) and inserting in lieu thereof the following:

"(3) BASIC STANDARD DEDUCTION.—In the case of an estate which does not itemize deductions, the basic standard deduction for the estate for the taxable year shall be the same as for a married individual filing a separate return for such year."

(15) SECTION 3402.—

(A) Paragraph (1) of section 3402(f) (relating to withholding exemptions) is amended by striking out subparagraphs (B) and (C) and by redesignating subparagraphs (D), (E), (F), and (G) as subparagraphs (B), (C), (D), and (E), respectively.

(B) Subparagraph (A) of section 3402(f)(1) is amended by inserting "unless he is an individual described in section 151(d)(2)" after "himself".

(C) Subparagraph (B) of section 3402(f)(1), as redesignated by subparagraph (A), is amended by striking out "subparagraph (A), (B), (C), or (F)" and inserting in lieu thereof "subparagraph (A) or (D)".

(D) Subparagraph (C) of section 3402(f)(1), as redesignated by subparagraph (A), is amended by striking out "section 151(e)" and inserting in lieu thereof "section 151(c)".

(E) Subparagraph (E) of section 3402(f)(1), as redesignated by subparagraph (A), is amended by striking out "zero bracket" and inserting in lieu thereof "standard deduction".

(F) The last sentence of paragraph (1) of section 3402(f) is amended—

(i) by striking out "subparagraph (G)" and inserting in lieu thereof "subparagraph (E)", and

(ii) by striking out "zero bracket" and inserting in lieu thereof "standard deduction".

(G) Paragraph (3) of section 3402(m) is amended by inserting "(including the additional standard deduction under section 63(c)(3) for the aged and blind)" after "deductions".

(16) SECTION 6014.—

(A) Subsection (a) of section 6014 (relating to income tax return—tax not computed by taxpayer) is amended by striking out "who does not have an unused zero bracket amount (determined under section 63(e))" and inserting in lieu thereof "who is not described in section 6012(a)(1)(C)(i)".

(B) Paragraph (4) of section 6014(b) is amended to read as follows:

"(4) to cases where the taxpayer itemizes his deductions or where the taxpayer claims a reduced standard deduction by reason of section 63(c)(5)."

(17) SECTION 6212.—Subparagraph (A) of section 6212(c)(2) (relating to cross references) is amended to read as follows:

"(A) Deficiency attributable to change of treatment with respect to itemized deductions, see section 63(e)(3)."

(18) SECTION 6504.—Paragraph (2) of section 6504 (relating to cross references) is amended to read as follows:

"(2) Change of treatment with respect to itemized deductions where taxpayer and his spouse make separate returns, see section 63(e)(3)."

Subtitle B—Provisions Related to Tax Credits

SEC. 111. INCREASE IN EARNED INCOME CREDIT.

(a) INCREASE IN AMOUNT OF CREDIT.—Subsection (a) of section 32 (relating to earned income credit) is amended—

(1) by striking out "11 percent" and inserting in lieu thereof "14 percent", and

(2) by striking out "$5,000" and inserting in lieu thereof "$5,714".

(b) INCREASE IN INCOME LEVEL AT WHICH PHASEOUT BEGINS.—Subsection (b) of section 32 is amended to read as follows:

"(b) LIMITATION.—The amount of the credit allowable to a taxpayer under subsection (a) for any taxable year shall not exceed the excess (if any) of—

"(1) the maximum credit allowable under subsection (a) to any taxpayer, over

"(2) 10 percent of so much of the adjusted gross income (or, if greater, the earned income) of the taxpayer for the taxable year as exceeds $9,000.

In the case of any taxable year beginning in 1987, paragraph (2) shall be applied by substituting '$6,500' for '$9,000'."

(c) INFLATION ADJUSTMENTS.—Section 32 is amended by adding at the end thereof the following new subsection:

"(i) INFLATION ADJUSTMENTS.—

"(1) IN GENERAL.—In the case of any taxable year beginning after the applicable calendar year, each dollar amount referred to in paragraph (2)(B) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3), for the calendar year in which the taxable year begins, by substituting 'calendar year 1984' for 'calendar year 1987' in subparagraph (B) thereof.

"(2) DEFINITIONS, ETC.—For purposes of paragraph (1)—

"(A) APPLICABLE CALENDAR YEAR.—The term 'applicable calendar year' means—

"(i) 1986 in the case of the dollar amounts referred to in clause (i) or (ii) of subparagraph (B), and

"(ii) 1987 in the case of the dollar amount referred to in clause (iii) of subparagraph (B).

"(B) DOLLAR AMOUNTS.—The dollar amounts referred to in this subparagraph are—

"(i) the $5,714 amount contained in subsection (a),

"(ii) the $6,500 amount contained in the last sentence of subsection (b), and

"(iii) the $9,000 amount contained in subsection (b)(2).

"(3) ROUNDING.—If any increase determined under paragraph (1) is not a multiple of $10, such increase shall be rounded to the nearest multiple of $10 (or, if such increase is a multiple of $5, such increase shall be increased to the next higher multiple of $10)."

(d) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 32(f) (relating to amount of credit to be determined under tables) is amended by striking out subparagraphs (A) and (B) and inserting in lieu thereof the following:

"(A) for earned income between $0 and the amount of earned income at which the credit is phased out under subsection (b), and

"(B) for adjusted gross income between the dollar amount at which the phaseout begins under subsection (b) and the amount of adjusted gross income at which the credit is phased out under subsection (b)."

(2) Subparagraph (B) of section 3507(c)(2) (relating to earned income advance amount) is amended by striking out clauses (i) and (ii) and inserting in lieu thereof the following:

"(i) of not more than 14 percent of earned income not in excess of the amount of earned income taken into account under section 32(a), which

"(ii) phases out between the amount of earned income at which the phaseout begins under subsection (b) of section 32 and the amount of earned income at which the credit under section 32 is phased out under such subsection, or".

(3) Subparagraph (C) of section 3507(c)(2) is amended by striking out clauses (i) and (ii) and inserting in lieu thereof the following:

"(i) of not more than 14 percent of earned income not in excess of ½ of the amount of earned income taken into account under section 32(a), which

"(ii) phases out between amounts of earned income which are ½ of the amounts of earned income described in subparagraph (B)(ii)."

(e) EMPLOYEE NOTIFICATION.—The Secretary of the Treasury is directed to require, under regulations, employers to notify any employee who has not had any tax withheld from wages (other than an employee whose wages are exempt from withholding pursuant to section 3402(n) of the Internal Revenue Code of 1986) that such employee may be eligible for a refund because of the earned income credit.

SEC. 112. REPEAL OF CREDIT FOR CONTRIBUTIONS TO CANDIDATES FOR PUBLIC OFFICE.

(a) GENERAL RULE.—Section 24 (relating to contributions to candidates for public office) is hereby repealed.

(b) TECHNICAL AMENDMENTS.—

(1) Subsection (g) of section 527 (relating to treatment of newsletter funds) is amended—

(A) by striking out "section 24(c)(2)" in paragraph (1) and inserting in lieu thereof "paragraph (3)", and

(B) by adding at the end thereof the following new paragraph:

"(3) CANDIDATE.—For purposes of paragraph (1), the term 'candidate' means, with respect to any Federal, State, or local elective public office, an individual who—

"(A) publicly announces that he is a candidate for nomination or election to such office, and

"(B) meets the qualifications prescribed by law to hold such office."

(2) Subsection (a) of section 642 (relating to credits against tax for estates and trusts) is amended to read as follows:

"(a) FOREIGN TAX CREDIT ALLOWED.—An estate or trust shall be allowed the credit against tax for taxes imposed by foreign countries and possessions of the United States, to the extent allowed by section 901, only in respect of so much of the taxes described in such section as is not properly allocable under such section to the beneficiaries."

(3) Paragraph (3) of section 901(i) (relating to cross references) is amended by striking out "section 642(a)(1)" and inserting in lieu thereof "section 642(a)".

(4) Paragraph (6) of section 7871(a) (relating to Indian tribal governments treated as States for certain purposes) is amended by striking out subparagraph (A) and by redesignating subparagraphs (B), (C), (D), (E), and (F) as subparagraphs (A), (B), (C), (D), and (E), respectively.

(5) The table of sections for subpart A of part IV of subchapter A of chapter 1 is amended by striking out the item relating to section 24.

Subtitle C—Provisions Related to Exclusions

SEC. 121. TAXATION OF UNEMPLOYMENT COMPENSATION.

Section 85 (relating to unemployment compensation) is amended to read as follows:

"SEC. 85. UNEMPLOYMENT COMPENSATION.

"(a) GENERAL RULE.—In the case of an individual, gross income includes unemployment compensation.

"(b) UNEMPLOYMENT COMPENSATION DEFINED.—For purposes of this section, the term 'unemployment compensation' means any amount received under a law of the United States or of a State which is in the nature of unemployment compensation."

SEC. 122. PRIZES AND AWARDS.

(a) EXCLUSION FROM GROSS INCOME.—

(1) In general.—Section 74 (relating to prizes and awards) is amended—

(A) by striking out "Except as provided in subsection (b) and" in subsection (a) and inserting in lieu thereof "Except as otherwise provided in this section or",

(B) by striking out "Exception" in the heading for subsection (b) and inserting in lieu thereof "Exception for Certain Prizes and Awards Transferred to Charities",

(C) by striking out "and" at the end of subsection (b)(1), by striking out the period at the end of subsection (b)(2) and inserting in lieu thereof "; and", and by adding after subsection (b)(2) the following new paragraph:

"(3) the prize or award is transferred by the payor to a governmental unit or organization described in paragraph (1) or (2) of section 170(c) pursuant to a designation made by the recipient.", and

(D) by adding at the end thereof the following new subsection:

"(c) Exception for Certain Employee Achievement Awards.—

"(1) In general.—Gross income shall not include the value of an employee achievement award (as defined in section 274(j)) received by the taxpayer if the cost to the employer of the employee achievement award does not exceed the amount allowable as a deduction to the employer for the cost of the employee achievement award.

"(2) Excess deduction award.—If the cost to the employer of the employee achievement award received by the taxpayer exceeds the amount allowable as a deduction to the employer, then gross income includes the greater of—

"(A) an amount equal to the portion of the cost to the employer of the award that is not allowable as a deduction to the employer (but not in excess of the value of the award), or

"(B) the amount by which the value of the award exceeds the amount allowable as a deduction to the employer.

The remaining portion of the value of such award shall not be included in the gross income of the recipient.

"(3) Treatment of tax-exempt employers.—In the case of an employer exempt from taxation under this subtitle, any reference in this subsection to the amount allowable as a deduction to the employer shall be treated as a reference to the amount which would be allowable as a deduction to the employer if the employer were not exempt from taxation under this subtitle.

"(4) Cross reference.—

"For provisions excluding certain de minimis fringes from gross income, see section 132(e)."

(2) Conforming amendments.—

(A) Clause (i) of section 4941(d)(2)(G) is amended by striking out "section 74(b)" and inserting in lieu thereof "section 74(b) (without regard to paragraph (3) thereof)".

(B) Paragraph (2) of section 4945(g) is amended by striking out "section 74(b)" and inserting in lieu thereof "section 74(b) (without regard to paragraph (3) thereof)".

(b) Amounts Transferred by Employer Not Excludable as Gifts.—Section 102 (relating to gifts and inheritances) is amended by adding at the end thereof the following new subsection:

"(c) Employee Gifts.—

"(1) In general.—Subsection (a) shall not exclude from gross income any amount transferred by or for an employer to, or for the benefit of, an employee.

"(2) Cross references.—

"For provisions excluding certain employee achievement awards from gross income, see section 74(c).

"For provisions excluding certain de minimis fringes from gross income, see section 132(e)."

(c) Gifts.—Section 274(b) (relating to gifts) is amended—

(1) by adding "or" at the end of subparagraph (A) of paragraph (1),

(2) by striking out "or" at the end of subparagraph (B) of paragraph (1), and inserting in lieu thereof a period,

(3) by striking out subparagraph (C) of paragraph (1), and

(4) by striking out paragraph (3).

(d) Deduction for Cost of Employee Achievement Awards.—Section 274 (relating to certain entertainment, etc., expenses) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) Employee Achievement Awards.—

"(1) General rule.—No deduction shall be allowed under section 162 or section 212 for the cost of an employee achievement award except to the extent that such cost does not exceed the deduction limitations of paragraph (2).

"(2) Deduction limitations.—The deduction for the cost of an employee achievement award made by an employer to an employee—

"(A) which is not a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year which are not qualified plan awards, shall not exceed $400, and

"(B) which is a qualified plan award, when added to the cost to the employer for all other employee achievement awards made to such employee during the taxable year (including employee achievement awards which are not qualified plan awards), shall not exceed $1,600.

"(3) Definitions.—For purposes of this subsection—

"(A) Employee achievement award.—The term 'employee achievement award' means an item of tangible personal property which is—

"(i) transferred by an employer to an employee for length of service achievement or safety achievement,

"(ii) awarded as part of a meaningful presentation, and *"(iii) awarded under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.*

"(B) QUALIFIED PLAN AWARD.—

"(i) IN GENERAL.—The term 'qualified plan award' means an employee achievement award awarded as part of an established written plan or program of the taxpayer which does not discriminate in favor of highly compensated employees (within the meaning of section 414(q)) as to eligibility or benefits.

"(ii) LIMITATION.—An employee achievement award shall not be treated as a qualified plan award for any taxable year if the average cost of all employee achievement awards which are provided by the employer during the year, and which would be qualified plan awards but for this subparagraph, exceeds $400. For purposes of the preceding sentence, average cost shall be determined by including the entire cost of qualified plan awards, without taking into account employee achievement awards of nominal value.

"(4) SPECIAL RULES.—For purposes of this subsection—

"(A) PARTNERSHIPS.—In the case of an employee achievement award made by a partnership, the deduction limitations contained in paragraph (2) shall apply to the partnership as well as to each member thereof.

"(B) LENGTH OF SERVICE AWARDS.—An item shall not be treated as having been provided for length of service achievement if the item is received during the recipient's 1st 5 years of employment or if the recipient received a length of service achievement award (other than an award excludable under section 132(e)(1)) during that year or any of the prior 4 years.

"(C) SAFETY ACHIEVEMENT AWARDS.—An item provided by an employer to an employee shall not be treated as having been provided for safety achievement if—

"(i) during the taxable year, employee achievement awards (other than awards excludable under section 132(e)(1)) for safety achievement have previously been awarded by the employer to more than 10 percent of the employees of the employer (excluding employees described in clause (ii)), or

"(ii) such item is awarded to a manager, administrator, clerical employee, or other professional employee.".

(e) TREATMENT FOR PURPOSES OF EMPLOYMENT TAXES.—Each of the following provisions are amended by striking out "117 or" and inserting in lieu thereof "74(c), 117, or":

(1) Section 3121(a)(20).

(2) Section 3231(e)(5).

(3) Section 3306(b)(16).

(4) Section 3401(a)(20).

(5) Section 209(s) of the Social Security Act.

SEC. 123. SCHOLARSHIPS.

(a) In General.—Section 117 (relating to scholarship and fellowship grants) is amended to read as follows:

"SEC. 117. QUALIFIED SCHOLARSHIPS.

"(a) General Rule.—Gross income does not include any amount received as a qualified scholarship by an individual who is a candidate for a degree at an educational organization described in section 170(b)(1)(A)(ii).

"(b) Qualified Scholarship.—For purposes of this section—

"(1) In general.—The term 'qualified scholarship' means any amount received by an individual as a scholarship or fellowship grant to the extent the individual establishes that, in accordance with the conditions of the grant, such amount was used for qualified tuition and related expenses.

"(2) Qualified tuition and related expenses.—For purposes of paragraph (1), the term 'qualified tuition and related expenses' means—

"(A) tuition and fees required for the enrollment or attendance of a student at an educational organization described in section 170(b)(1)(A)(ii), and

"(B) fees, books, supplies, and equipment required for courses of instruction at such an educational organization.

"(c) Limitation.—Subsections (a) and (d) shall not apply to that portion of any amount received which represents payment for teaching, research, or other services by the student required as a condition for receiving the qualified scholarship or qualified tuition reduction.

"(d) Qualified Tuition Reduction.—

"(1) In general.—Gross income shall not include any qualified tuition reduction.

"(2) Qualified tuition reduction.—For purposes of this subsection, the term 'qualified tuition reduction' means the amount of any reduction in tuition provided to an employee of an organization described in section 170(b)(1)(A)(ii) for the education (below the graduate level) at such organization (or another organization described in section 170(b)(1)(A)(ii)) of—

"(A) such employee, or

"(B) any person treated as an employee (or whose use is treated as an employee use) under the rules of section 132(f).

"(3) Reduction must not discriminate in favor of highly compensated, etc.—Paragraph (1) shall apply with respect to any qualified tuition reduction provided with respect to any officer, owner, or highly compensated employee only if such reduction is available on substantially the same terms to each member of a group of employees which is defined under a reasonable classification set up by the employer which does not discriminate in favor of officers, owners, or highly compensated employees (within the meaning of section 414(q))."

(b) Technical Amendments.—

(1) Subsection (a) of section 74 is amended by striking out "(relating to scholarship and fellowship grants)" and inserting in lieu thereof "(relating to qualified scholarships)".

(2) The second sentence of section 1441(b) (relating to income items) is amended to read as follows: "The items of income referred to in subsection (a) from which tax shall be deducted and withheld at the rate of 14 percent are amounts which are received by a nonresident alien individual who is temporarily present in the United States as a nonimmigrant under subparagraph (F) or (J) of section 101(a)(15) of the Immigration and Nationality Act and which are incident to a qualified scholarship to which section 117(a) applies, but only to the extent such amounts are includible in gross income."

(3) Paragraph (6) of section 7871(a) (relating to Indian tribal governments treated as States for certain purposes), as amended by section 112, is amended by striking out subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively.

(4) The table of sections for part III of subchapter B of chapter 1 is amended by striking out the item relating to section 117 and inserting in lieu thereof the following new item:

"Sec. 117. Qualified scholarships."

Subtitle D—Provisions Related to Deductions

SEC. 131. REPEAL OF DEDUCTION FOR 2-EARNER MARRIED COUPLES.

(a) GENERAL RULE.—Section 221 (relating to deduction for 2-earner married couples) is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) Section 62 is amended by striking out paragraph (16).

(2) Subparagraph (A) of section 86(b)(2) is amended by striking out "sections 221," and inserting in lieu thereof "sections".

(3) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out the item relating to section 221.

SEC. 132. 2-PERCENT FLOOR ON MISCELLANEOUS ITEMIZED DEDUCTIONS.

(a) GENERAL RULE.—Part I of subchapter B of chapter 1 (defining gross income, adjusted gross income, etc.) is amended by adding at the end thereof the following new section:

"SEC. 67. 2-PERCENT FLOOR ON MISCELLANEOUS ITEMIZED DEDUCTIONS.

"(a) GENERAL RULE.—In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income.

"(b) MISCELLANEOUS ITEMIZED DEDUCTIONS.—For purposes of this section, the term 'miscellaneous itemized deductions' means the itemized deductions other than—

"(1) the deduction under section 163 (relating to interest),

"(2) the deduction under section 164 (relating to taxes),

"(3) the deduction under section 165(a) for losses described in subsection (c)(3) or (d) of section 165,

"(4) the deduction under section 170 (relating to charitable, etc., contributions and gifts),

"(5) the deduction under section 213 (relating to medical, dental, etc., expenses),

"(6) the deduction under section 217 (relating to moving expenses),

"(7) any deduction allowable for impairment-related work expenses,

"(8) the deduction under section 691(c) (relating to deduction for estate tax in case of income in respect of the decedent),

"(9) any deduction allowable in connection with personal property used in a short sale,

"(10) the deduction under section 1341 (relating to computation of tax where taxpayer restores substantial amount held under claim of right),

"(11) the deduction under section 72(b)(3) (relating to deduction where annuity payments cease before investment recovered),

"(12) the deduction under section 171 (relating to deduction for amortizable bond premium), and

"(13) the deduction under section 216 (relating to deductions in connection with cooperative housing corporations).

"(c) Disallowance of Indirect Deduction Through Pass-Thru Entity.—The Secretary shall prescribe regulations which prohibit the indirect deduction through pass-thru entities of amounts which are not allowable as a deduction if paid or incurred directly by an individual and which contain such reporting requirements as may be necessary to carry out the purposes of this subsection. The preceding sentence shall not apply with respect to estates, trusts, cooperatives, and real estate investment trusts.

"(d) Impairment-Related Work Expenses.—For purposes of this section, the term 'impairment-related work expenses' means expenses—

"(1) of a handicapped individual (as defined in section 190(b)(3)) for attendant care services at the individual's place of employment and other expenses in connection with such place of employment which are necessary for such individual to be able to work, and

"(2) with respect to which a deduction is allowable under section 162 (determined without regard to this section).

"(e) Determination of Adjusted Gross Income in Case of Estates and Trusts.—For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and would not have been incurred if the property were not held in such trust or estate shall be treated as allowable in arriving at adjusted gross income."

(b) Treatment of Trade and Business Deductions of Employees.—

(1) In general.—Paragraph (2) of section 62 (defining adjusted gross income) is amended to read as follows:

"(2) Certain trade and business deductions of employees.—

"(A) Reimbursed expenses of employees.—The deductions allowed by part VI (section 161 and following) which consist of expenses paid or incurred by the taxpayer, in connection with the performance by him of services as an em-

ployee, under a reimbursement or other expense allowance arrangement with his employer.

"(B) Certain expenses of performing artists.—The deductions allowed by section 162 which consist of expenses paid or incurred by a qualified performing artist in connection with the performances by him of services in the performing arts as an employee."

(2) Definition of qualified performing artist.—Section 62 is amended—

(A) by striking out "For purposes of this subtitle" and inserting in lieu thereof "(a) General Rule.—For purposes of this subtitle", and

(B) by adding at the end thereof the following new subsection:

"(b) Qualified Performing Artist.—

"(1) In general.—For purposes of subsection (a)(2)(B), the term 'qualified performing artist' means, with respect to any taxable year, any individual if—

"(A) such individual performed services in the performing arts as an employee during the taxable year for at least 2 employers,

"(B) the aggregate amount allowable as a deduction under section 162 in connection with the performance of such services exceeds 10 percent of such individual's gross income attributable to the performance of such services, and

"(C) the adjusted gross income of such individual for the taxable year (determined without regard to subsection (a)(2)(B)) does not exceed $16,000.

"(2) Nominal employer not taken into account.—An individual shall not be treated as performing services in the performing arts as an employee for any employer during any taxable year unless the amount received by such individual from such employer for the performance of such services during the taxable year equals or exceeds $200.

"(3) Special rules for married couples.—

"(A) In general.—Except in the case of a husband and wife who lived apart at all times during the taxable year, if the taxpayer is married at the close of the taxable year, subsection (a)(2)(B) shall apply only if the taxpayer and his spouse file a joint return for the taxable year.

"(B) Application of paragraph (1).—In the case of a joint return—

"(i) paragraph (1) (other than subparagraph (C) thereof) shall be applied separately with respect to each spouse, but

"(ii) paragraph (1)(C) shall be applied with respect to their combined adjusted gross income.

"(C) Determination of marital status.—For purposes of this subsection, marital status shall be determined under section 7703(a).

"(D) Joint return.—For purposes of this subsection, the term 'joint return' means the joint return of a husband and wife made under section 6013."

(c) Moving Expense Deduction Not Allowable in Computing Adjusted Gross Income.—Subsection (a) of section 62 (as amended by subsection (b)) is amended by striking out paragraph (8).

(d) Clerical Amendment.—The table of sections for part I of subchapter B of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 67. 2-percent floor on miscellaneous itemized deductions."

SEC. 133. MEDICAL EXPENSE DEDUCTION LIMITATION INCREASED.

Subsection (a) of section 213 (relating to deduction for medical, dental, etc., expenses) is amended by striking out "5 percent" and inserting in lieu thereof "7.5 percent".

SEC. 134. REPEAL OF DEDUCTION FOR STATE AND LOCAL SALES TAXES.

(a) General Rule.—Subsection (a) of section 164 (relating to deduction for taxes) is amended—

(1) by striking out paragraph (4) and by redesignating paragraph (5) as paragraph (4), and

(2) by adding at the end thereof the following new sentence: "Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition."

(b) Conforming Amendments.—Subsection (b) of section 164 is amended—

(1) by striking out paragraphs (2) and (5), and

(2) by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

SEC. 135. REPEAL OF DEDUCTION FOR ADOPTION EXPENSES.

(a) General Rule.—Section 222 (relating to deduction for adoption expenses) is hereby repealed.

(b) Conforming Amendments.—

(1) Section 223 is redesignated as section 220.

(2) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out the items relating to sections 222 and 223 and inserting in lieu thereof the following:

"Sec. 220. Cross references."

Subtitle E—Miscellaneous Provisions

SEC. 141. REPEAL OF INCOME AVERAGING.

(a) General Rule.—Part I of subchapter Q of chapter 1 (relating to income averaging) is hereby repealed.

(b) Technical Amendments.—

(1) Subsection (b) of section 3 (relating to section inapplicable to certain individuals) is amended by striking out paragraph (1) and by redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(2) Subsection (b) of section 5 (relating to cross references relating to tax on individuals) is amended by striking out paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(3) Subparagraph (B) of section 6511(d)(2) (relating to special rules applicable to income taxes) is amended to read as follows:

"(B) APPLICABLE RULES.—

"(i) IN GENERAL.—If the allowance of a credit or refund of an overpayment of tax attributable to a net operating loss carryback or a capital loss carryback is otherwise prevented by the operation of any law or rule of law other than section 7122 (relating to compromises), such credit or refund may be allowed or made, if claim therefor is filed within the period provided in subparagraph (A) of this paragraph.

"(ii) TENTATIVE CARRYBACK ADJUSTMENTS.—If the allowance of an application, credit, or refund of a decrease in tax determined under section 6411(b) is otherwise prevented by the operation of any law or rule of law other than section 7122, such application, credit, or refund may be allowed or made if application for a tentative carryback adjustment is made within the period provided in section 6411(a).

"(iii) DETERMINATIONS BY COURTS TO BE CONCLUSIVE.—In the case of any such claim for credit or refund or any such application for a tentative carryback adjustment, the determination by any court, including the Tax Court, in any proceeding in which the decision of the court has become final, shall be conclusive except with respect to—

"(I) the net operating loss deduction and the effect of such deduction, and

"(II) the determination of a short-term capital loss and the effect of such short-term capital loss, to the extent that such deduction or short-term capital loss is affected by a carryback which was not an issue in such proceeding."

(c) CLERICAL AMENDMENT.—The table of parts for subchapter Q of chapter 1 is amended by striking out the item relating to part I.

SEC. 142. LIMITATIONS ON DEDUCTIONS FOR MEALS, TRAVEL, AND ENTERTAINMENT.

(a) BUSINESS MEALS.—

(1) IN GENERAL.—Section 274 (relating to disallowance of certain entertainment, etc. expenses), as amended by section 122(d), is amended by redesignating subsection (k) as subsection (o) and by inserting after subsection (j) the following new subsection:

"(k) BUSINESS MEALS.—

"(1) IN GENERAL.—No deduction shall be allowed under this chapter for the expense of any food or beverages unless—

"(A) such expense is not lavish or extravagant under the circumstances, and

"(B) the taxpayer (or an employee of the taxpayer) is present at the furnishing of such food or beverages.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any expense if subsection (a) does not apply to such expense by reason of paragraph (2), (3), (4), (7), (8), or (9) of subsection (e)."

(2) TECHNICAL AMENDMENTS.—

(A) Subsection (e) of section 274 (relating to specific exceptions to application of subsection (a)) is amended by striking out paragraph (1) and by redesignating paragraphs (2) through (10) as paragraphs (1) through (9), respectively.

(B) Paragraph (3) of section 274(e), as redesignated by subparagraph (A), is amended by striking out "paragraph (3)" and inserting in lieu thereof "paragraph (2)".

(b) ADDITIONAL RESTRICTIONS ON EXPENSES FOR MEALS, TRAVEL, AND ENTERTAINMENT.—Section 274 is amended by inserting after the subsection added by subsection (a) the following new subsections:

"(l) ADDITIONAL LIMITATIONS ON ENTERTAINMENT TICKETS.—

"(1) ENTERTAINMENT TICKETS.—

"(A) IN GENERAL.—In determining the amount allowable as a deduction under this chapter for any ticket for any activity or facility described in subsection (d)(2), the amount taken into account shall not exceed the face value of such ticket.

"(B) EXCEPTION FOR CERTAIN CHARITABLE SPORTS EVENTS.—Subparagraph (A) shall not apply to any ticket for any sports event—

"(i) which is organized for the primary purpose of benefiting an organization which is described in section 501(c)(3) and exempt from tax under section 501(a),

"(ii) all of the net proceeds of which are contributed to such organization, and

"(iii) which utilizes volunteers for substantially all of the work performed in carrying out such event.

"(2) SKYBOXES, ETC.—

"(A) IN GENERAL.—In the case of a skybox or other private luxury box leased for more than 1 event, the amount allowable as a deduction under this chapter with respect to such events shall not exceed the sum of the face value of non-luxury box seat tickets for the seats in such box covered by the lease. For purposes of the preceding sentence, 2 or more related leases shall be treated as 1 lease.

"(B) PHASEIN.—In the case of—

"(i) a taxable year beginning in 1987, the amount disallowed under subparagraph (A) shall be ⅓ of the amount which would be disallowed without regard to this subparagraph, and

"(ii) in the case of a taxable year beginning in 1988, the amount disallowed under subparagraph (A) shall be ⅔ of the amount which would have been disallowed without regard to this subparagraph."

"(m) ADDITIONAL LIMITATIONS ON TRAVEL EXPENSES.—

"(1) LUXURY WATER TRANSPORTATION.—

"(A) IN GENERAL.—No deduction shall be allowed under this chapter for expenses incurred for transportation by water to the extent such expenses exceed twice the aggregate per diem amounts for days of such transportation. For purposes of the preceding sentence, the term 'per diem amounts' means the highest amount generally allowable with respect to a day to employees of the executive branch

of the Federal Government for per diem while away from home but serving in the United States.

"(B) EXCEPTIONS.—Subparagraph (A) shall not apply to—

"(i) any expense allocable to a convention, seminar, or other meeting which is held on any cruise ship, and

"(ii) any expense to which subsection (a) does not apply by reason of paragraph (2), (3), (4), (7), (8), or (9) of subsection (e).

"(2) TRAVEL AS FORM OF EDUCATION.—No deduction shall be allowed under this chapter for expenses for travel as a form of education.

"(n) ONLY 80 PERCENT OF MEAL AND ENTERTAINMENT EXPENSES ALLOWED AS DEDUCTION.—

"(1) IN GENERAL.—The amount allowable as a deduction under this chapter for—

"(A) any expense for food or beverages, and

"(B) any item with respect to an activity which is of a type generally considered to constitute entertainment, amusement, or recreation, or with respect to a facility used in connection with such activity,

shall not exceed 80 percent of the amount of such expense or item which would (but for this paragraph) be allowable as a deduction under this chapter.

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any expense if—

"(A) subsection (a) does not apply to such expense by reason of paragraph (2), (3), (4), (7), (8), or (9) of subsection (e),

"(B) in the case of an expense for food or beverages, such expense is excludable from the gross income of the recipient under section 132 by reason of subsection (e) thereof (relating to de minimis fringes),

"(C) such expense is covered by a package involving a ticket described in subsection (l)(1)(B), or

"(D) in the case of an expense for food or beverages before January 1, 1989, such expense is an integral part of a qualified meeting.

"(3) QUALIFIED MEETING.—For purposes of paragraph (2)(D), the term 'qualified meeting' means any convention, seminar, annual meeting, or similar business program with respect to which—

"(A) an expense for food or beverages is not separately stated,

"(B) more than 50 percent of the participants are away from home,

"(C) at least 40 individuals attend, and

"(D) such food and beverages are part of a program which includes a speaker."

(c) NO DEDUCTION ALLOWED FOR SEMINARS, ETC., FOR SECTION 212 PURPOSES.—

(1) IN GENERAL.—Subsection (h) of section 274 (relating to attendance at conventions, etc.) is amended by adding at the end thereof the following new paragraph:

"(7) SEMINARS, ETC. FOR SECTION 212 PURPOSES.—No deduction shall be allowed under section 212 for expenses allocable to a convention, seminar, or similar meeting."

(2) TECHNICAL AMENDMENTS.—Paragraphs (1), (2), (4), and (5) of section 274(h) are each amended—

(A) by striking out "or 212" each place it appears, and

(B) by striking out "or to an activity described in section 212 and" each place it appears.

(d) DENIAL OF CHARITABLE CONTRIBUTION FOR CERTAIN TRAVEL EXPENSES.—Section 170 (relating to charitable, etc., contributions and gifts) is amended by redesignating subsections (k) and (l) as subsections (l) and (m), respectively, and by inserting after subsection (j) the following new subsection:

"(k) DENIAL OF DEDUCTION FOR CERTAIN TRAVEL EXPENSES.—No deduction shall be allowed under this section for traveling expenses (including amounts expended for meals and lodging) while away from home, whether paid directly or by reimbursement, unless there is no significant element of personal pleasure, recreation, or vacation in such travel."

SEC. 143. CHANGES IN TREATMENT OF HOBBY LOSS, ETC.

(a) HOBBY LOSS.—Subsection (d) of section 183 (relating to presumption) is amended—

(1) by striking out "2 or more of the taxable years in the period of 5 consecutive taxable years" and inserting in lieu thereof "3 or more of the taxable years in the period of 5 consecutive taxable years", and

(2) by striking out the last sentence and inserting in lieu thereof the following: "In the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, the preceding sentence shall be applied by substituting '2' for '3' and '7' for '5'."

(b) TREATMENT OF RENTAL TO EMPLOYER UNDER SECTION 280A.—Subsection (c) of section 280A (relating to exceptions for certain business or rental use; limitation on deductions for such use) is amended by adding at the end thereof the following new paragraph:

"(6) TREATMENT OF RENTAL TO EMPLOYER.—Paragraphs (1) and (3) shall not apply to any item which is attributable to the rental of the dwelling unit (or any portion thereof) by the taxpayer to his employer during any period in which the taxpayer uses the dwelling unit (or portion) in performing services as an employee of the employer."

(c) REVISION OF LIMITATION ON DEDUCTION FOR BUSINESS USE OF HOME.—Paragraph (5) of section 280A(c) (relating to exceptions for certain business or rental use; limitation on deductions for such use) is amended by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) the sum of—

"(i) the deductions allocable to such use which are allowable under this chapter for the taxable year whether or not such unit (or portion thereof) was so used, and *"(ii) the deductions allocable to the trade or business in which such use occurs (but which are not allocable to such use) for such taxable year.*

Any amount not allowable as a deduction under this chapter by reason of the preceding sentence shall be taken into account as a deduction (allocable to such use) under this chapter for the succeeding taxable year."

SEC. 144. DEDUCTION FOR MORTGAGE INTEREST AND REAL PROPERTY TAXES ALLOWABLE WHERE PARSONAGE ALLOWANCE OR MILITARY HOUSING ALLOWANCE RECEIVED.

Section 265 (relating to expenses and interest relating to tax-exempt income) is amended by adding at the end thereof the following new paragraph:

"(6) SECTION NOT TO APPLY WITH RESPECT TO PARSONAGE AND MILITARY HOUSING ALLOWANCES.—No deduction shall be denied under this section for interest on a mortgage on, or real property taxes on, the home of the taxpayer by reason of the receipt of an amount as—

"(A) a military housing allowance, or

"(B) a parsonage allowance excludable from gross income under section 107."

Subtitle F—Effective Dates

SEC. 151. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this title shall apply to taxable years beginning after December 31, 1986.

(b) UNEMPLOYMENT COMPENSATION.—The amendment made by section 121 shall apply to amounts received after December 31, 1986, in taxable years ending after such date.

(c) PRIZES AND AWARDS.—The amendments made by section 122 shall apply to prizes and awards granted after December 31, 1986.

(d) SCHOLARSHIPS.—The amendments made by section 123 shall apply to taxable years beginning after December 31, 1986, but only in the case of scholarships and fellowships granted after August 16, 1986.

(e) PARSONAGE AND MILITARY HOUSING ALLOWANCES.—The amendment made by section 144 shall apply to taxable years beginning before, on, or after, December 31, 1986.

TITLE II—PROVISIONS RELATING TO CAPITAL COST

Subtitle A—Depreciation Provisions

SEC. 201. MODIFICATION OF ACCELERATED COST RECOVERY SYSTEM.

(a) GENERAL RULE.—Section 168 (relating to accelerated cost recovery system) is amended to read as follows:

"SEC. 168. ACCELERATED COST RECOVERY SYSTEM.

"(a) GENERAL RULE.—Except as otherwise provided in this section, the depreciation deduction provided by section 167(a) for any tangible property shall be determined by using—

"(1) the applicable depreciation method,

"(2) the applicable recovery period, and

"(3) the applicable convention.

"(b) APPLICABLE DEPRECIATION METHOD.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the applicable depreciation method is—

"(A) the 200 percent declining balance method,

"(B) switching to the straight line method for the 1st taxable year for which using the straight line method with respect to the adjusted basis as of the beginning of such year will yield a larger allowance.

"(2) 15-YEAR AND 20-YEAR PROPERTY.—In the case of 15-year and 20-year property, paragraph (1) shall be applied by substituting '150 percent' for '200 percent'.

"(3) PROPERTY TO WHICH STRAIGHT LINE METHOD APPLIES.—The applicable depreciation method shall be the straight line method in the case of the following property:

"(A) Nonresidential real property.

"(B) Residential rental property.

"(C) Property with respect to which the taxpayer elects under paragraph (5) to have the provisions of this paragraph apply.

"(4) SALVAGE VALUE TREATED AS ZERO.—Salvage value shall be treated as zero.

"(5) ELECTION.—An election under paragraph (3)(C) may be made with respect to 1 or more classes of property for any taxable year and once made with respect to any class shall apply to all property in such class placed in service during such taxable year. Such an election, once made, shall be irrevocable.

"(c) APPLICABLE RECOVERY PERIOD.—For purposes of this section, the applicable recovery period shall be determined in accordance with the following table:

"In the case of:	*The applicable recovery period is:*
3-year property	*3 years*
5-year property	*5 years*
7-year property	*7 years*
10-year property	*10 years*
15-year property	*15 years*
20-year property	*20 years*
Residential rental property	*27.5 years*
Nonresidential real property	*31.5 years.*

"(d) APPLICABLE CONVENTION.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the applicable convention is the half-year convention.

"(2) REAL PROPERTY.—In the case of—

"(A) nonresidential real property, and

"(B) residential rental property,

the applicable convention is the mid-month convention.

"(3) SPECIAL RULE WHERE SUBSTANTIAL PROPERTY PLACED IN SERVICE DURING LAST 3 MONTHS OF TAXABLE YEAR.—

"(A) IN GENERAL.—Except as provided in regulations, if during any taxable year—

"(i) the aggregate bases of property to which this section applies and which are placed in service during the last 3 months of the taxable year, exceed

"(ii) 40 percent of the aggregate bases of property to which this section applies placed in service during such taxable year,

the applicable convention for all property to which this section applies placed in service during such taxable year shall be the mid-quarter convention.

"(B) CERTAIN REAL PROPERTY NOT TAKEN INTO ACCOUNT.—For purposes of subparagraph (A), nonresidential real property and residential rental property shall not be taken into account.

"(4) DEFINITIONS.—

"(A) HALF-YEAR CONVENTION.—The half-year convention is a convention which treats all property placed in service during any taxable year (or disposed of during any taxable year) as placed in service (or disposed of) on the mid-point of such taxable year.

"(B) MID-MONTH CONVENTION.—The mid-month convention is a convention which treats all property placed in service during any month (or disposed of during any month) as placed in service (or disposed of) on the mid-point of such month.

"(C) MID-QUARTER CONVENTION.—The mid-quarter convention is a convention which treats all property placed in service during any quarter of a taxable year (or disposed of during any quarter of a taxable year) as placed in service (or disposed of) on the mid-point of such quarter.

"(e) CLASSIFICATION OF PROPERTY.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, property shall be classified under the following table:

"Property shall be treated as:	*If such property has a class life (in years) of:*
3-year property	*4 or less*
5-year property	*More than 4 but less than 10*
7-year property	*10 or more but less than 16*
10-year property	*16 or more but less than 20*
15-year property	*20 or more but less than 25*
20-year property	*25 or more.*

"(2) RESIDENTIAL RENTAL OR NONRESIDENTIAL REAL PROPERTY.—

"(A) RESIDENTIAL RENTAL PROPERTY.—The term 'residential rental property' has the meaning given such term by section 167(j)(2)(B).

"(B) NONRESIDENTIAL REAL PROPERTY.—The term 'nonresidential real property' means section 1250 property which is not—

"(i) residential rental property, or

"(ii) property with a class life of less than 27.5 years.

"(3) CLASSIFICATION OF CERTAIN PROPERTY.—

"(A) 3-YEAR PROPERTY.—The term '3-year property' includes—

"(i) any race horse which is more than 2 years old at the time it is placed in service, and

"(ii) any horse other than a race horse which is more than 12 years old at the time it is placed in service.

"(B) 5-YEAR PROPERTY.—The term '5-year property' includes—

"(i) any automobile or light general purpose truck,

"(ii) any semi-conductor manufacturing equipment,

"(iii) any computer-based telephone central office switching equipment,

"(iv) any qualified technological equipment,

"(v) any property used in connection with research and experimentation, and

"(vi) any property which—

"(I) is described in paragraph (3)(A)(viii), (3)(A)(ix), or (4) of section 48(l), or

"(II) is described in paragraph (15) of section 48(l) and is a qualifying small power production facility within the meaning of section 3(17)(C) of the Federal Power Act (16 U.S.C. 796(17)(C)), as in effect on September 1, 1986.

"(C) 7-YEAR PROPERTY.—The term '7-year property' includes—

"(i) any railroad track,

"(ii) any single-purpose agricultural or horticultural structure (within the meaning of section 48(p)), and

"(iii) any property which—

"(I) does not have a class life, and

"(II) is not otherwise classified under paragraph (2) or this paragraph.

"(D) 15-YEAR PROPERTY.—The term '15-year property' includes—

"(i) any municipal wastewater treatment plant, and

"(ii) any telephone distribution plant and comparable equipment used for 2-way exchange of voice and data communications.

"(E) 20-YEAR PROPERTY.—The term '20-year property' includes any municipal sewers.

"(f) PROPERTY TO WHICH SECTION DOES NOT APPLY.—This section shall not apply to—

"(1) CERTAIN METHODS OF DEPRECIATION.—Any property if—

"(A) the taxpayer elects to exclude such property from the application of this section, and

"(B) for the 1st taxable year for which a depreciation deduction would be allowable with respect to such property in the hands of the taxpayer, the property is properly depreciated under the unit-of-production method or any method of depreciation not expressed in a term of years (other than the retirement-replacement-betterment method or similar method).

"(2) CERTAIN PUBLIC UTILITY PROPERTY.—*Any public utility property (within the meaning of section 167(l)(3)(A)) if the taxpayer does not use a normalization method of accounting.*

"(3) FILMS AND VIDEO TAPE.—*Any motion picture film or video tape.*

"(4) SOUND RECORDINGS.—*Any sound recording described in section 48(r)(5).*

"(5) CERTAIN PROPERTY PLACED IN SERVICE IN CHURNING TRANSACTIONS.—

"(A) IN GENERAL.—*Property—*

"(i) described in paragraph (4) of section 168(e) (as in effect before the amendments made by the Tax Reform Act of 1986), or

"(ii) which would be described in such paragraph if such paragraph were applied by substituting '1987' for '1981' and '1986' for '1980' each place such terms appear.

"(B) SUBPARAGRAPH (A)(II) NOT TO APPLY.—*Clause (ii) of subparagraph (A) shall not apply to—*

"(i) any residential rental property or nonresidential real property, or

"(ii) any property if, for the 1st full taxable year in which such property is placed in service—

"(I) the amount allowable as a deduction under this section (as in effect before the date of the enactment of this paragraph) with respect to such property is greater than

"(II) the amount allowable as a deduction under this section (as in effect on or after such date and using the half-year convention) for such taxable year.

"(g) ALTERNATIVE DEPRECIATION SYSTEM FOR CERTAIN PROPERTY.—

"(1) IN GENERAL.—*In the case of—*

"(A) any tangible property which during the taxable year is used predominantly outside the United States,

"(B) any tax-exempt use property,

"(C) any tax-exempt bond financed property,

"(D) any imported property covered by an Executive order under paragraph (6), and

"(E) any property to which an election under paragraph (7) applies,

the depreciation deduction provided by section 167(a) shall be determined under the alternative depreciation system.

"(2) ALTERNATIVE DEPRECIATION SYSTEM.—*For purposes of paragraph (1), the alternative depreciation system is depreciation determined by using—*

"(A) the straight line method (without regard to salvage value),

"(B) the applicable convention determined under subsection (d), and

"(C) a recovery period determined under the following table:

"In the case of:	The recovery period shall be:
(i) Property not described in clause (ii) or (iii)	The class life.
(ii) Personal property with no class life	12 years.
(iii) Nonresidential real and residential rental property	40 years.

"(3) SPECIAL RULES FOR DETERMINING CLASS LIFE.—

"(A) TAX-EXEMPT USE PROPERTY SUBJECT TO LEASE.—In the case of any tax-exempt use property subject to a lease, the recovery period used for purposes of paragraph (2) shall in no event be less than 125 percent of the lease term.

"(B) SPECIAL RULE FOR CERTAIN PROPERTY ASSIGNED TO CLASSES.—For purposes of paragraph (2), in the case of property described in any of the following subparagraphs of subsection (e)(3), the class life shall be determined as follows:

"If property is described in subparagraph:	The class life is:
(B)(ii)	5
(B)(iii)	9.5
(C)(i)	10
(C)(ii)	15
(D)(i)	24
(D)(ii)	24
(E)	50.

"(C) QUALIFIED TECHNOLOGICAL EQUIPMENT.—In the case of any qualified technological equipment, the recovery period used for purposes of paragraph (2) shall be 5 years.

"(D) AUTOMOBILES, ETC.—In the case of any automobile or light general purpose truck, the recovery period used for purposes of paragraph (2) shall be 5 years.

"(E) CERTAIN REAL PROPERTY.—In the case of any section 1245 property which is real property with no class life, the recovery period used for purposes of paragraph (2) shall be 40 years.

"(4) PROPERTY USED PREDOMINANTLY OUTSIDE THE UNITED STATES.—For purposes of this subsection, rules similar to the rules under section 48(a)(2) (including the exceptions contained in subparagraph (B) thereof) shall apply in determining whether property is used predominantly outside the United States. In addition to the exceptions contained in such subparagraph (B), there shall be excepted any satellite or other spacecraft (or any interest therein) held by a United States person if such satellite or spacecraft was launched from within the United States.

"(5) TAX-EXEMPT BOND FINANCED PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term 'tax-exempt bond financed property' means any property to the extent such property is financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a).

"(B) ALLOCATION OF BOND PROCEEDS.—For purposes of subparagraph (A), the proceeds of any obligation shall be treated as used to finance property acquired in connection with the issuance of such obligation in the order in which such property is placed in service.

"(C) QUALIFIED RESIDENTIAL RENTAL PROJECTS.—The term 'tax-exempt bond financed property' shall not include any qualified residential rental project (within the meaning of section 142(a)(7)).

"(6) IMPORTED PROPERTY.—

"(A) COUNTRIES MAINTAINING TRADE RESTRICTIONS OR ENGAGING IN DISCRIMINATORY ACTS.—If the President determines that a foreign country—

"(i) maintains nontariff trade restrictions, including variable import fees, which substantially burden United States commerce in a manner inconsistent with provisions of trade agreements, or

"(ii) engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce,

the President may by Executive order provide for the application of paragraph (1)(D) to any article or class of articles manufactured or produced in such foreign country for such period as may be provided by such Executive order. Any period specified in the preceding sentence shall not apply to any property ordered before (or the construction, reconstruction, or erection of which began before) the date of the Executive order unless the President determines an earlier date to be in the public interest and specifies such date in the Executive order.

"(B) IMPORTED PROPERTY.—For purposes of this subsection, the term 'imported property' means any property if—

"(i) such property was completed outside the United States, or

"(ii) less than 50 percent of the basis of such property is attributable to value added within the United States.

For purposes of this subparagraph, the term 'United States' includes the Commonwealth of Puerto Rico and the possessions of the United States.

"(7) ELECTION TO USE ALTERNATIVE DEPRECIATION SYSTEM.—

"(A) IN GENERAL.—If the taxpayer makes an election under this paragraph with respect to any class of property for any taxable year, the alternative depreciation system under this subsection shall apply to all property in such class placed in service during such taxable year. Notwithstanding the preceding sentence, in the case of nonresidential real property or residential rental property, such election may be made separately with respect to each property.

"(B) ELECTION IRREVOCABLE.—An election under subparagraph (A), once made, shall be irrevocable.

"(h) TAX-EXEMPT USE PROPERTY.—

"(1) IN GENERAL.—For purposes of this section—

"(A) PROPERTY OTHER THAN NONRESIDENTIAL REAL PROPERTY.—Except as otherwise provided in this subsection, the term 'tax-exempt use property' means that portion of any tangible property (other than nonresidential real property) leased to a tax-exempt entity.

"(B) NONRESIDENTIAL REAL PROPERTY.—

"(i) In general.—In the case of nonresidential real property, the term 'tax-exempt use property' means that portion of the property leased to a tax-exempt entity in a disqualified lease.

"(ii) Disqualified lease.—For purposes of this subparagraph, the term 'disqualified lease' means any lease of the property to a tax-exempt entity, but only if—

"(I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a) and such entity (or a related entity) participated in such financing,

"(II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option,

"(III) such lease has a lease term in excess of 20 years, or

"(IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

"(iii) 35-percent threshold test.—Clause (i) shall apply to any property only if the portion of such property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property.

"(iv) Treatment of improvements.—For purposes of this subparagraph, improvements to a property (other than land) shall not be treated as a separate property.

"(v) Leasebacks during 1st 3 months of use not taken into account.—Subclause (IV) of clause (ii) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).

"(C) Exception for short-term leases.—

"(i) In general.—Property shall not be treated as tax-exempt use property merely by reason of a short-term lease.

"(ii) Short-term lease.—For purposes of clause (i), the term 'short-term lease' means any lease the term of which is—

"(I) less than 3 years, and

"(II) less than the greater of 1 year or 30 percent of the property's present class life.

In the case of nonresidential real property and property with no present class life, subclause (II) shall not apply.

"(D) Exception where property used in unrelated trade or business.—The term 'tax-exempt use property' shall not include any portion of a property if such portion is predominantly used by the tax-exempt entity (directly or

through a partnership of which such entity is a partner) in an unrelated trade or business the income of which is subject to tax under section 511. For purposes of subparagraph (B)(iii), any portion of a property so used shall not be treated as leased to a tax-exempt entity in a disqualified lease.

"(E) NONRESIDENTIAL REAL PROPERTY DEFINED.—For purposes of this paragraph, the term 'nonresidential real property' includes residential rental property.

"(2) TAX-EXEMPT ENTITY.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'tax-exempt entity' means—

"(i) the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing,

"(ii) an organization (other than a cooperative described in section 521) which is exempt from tax imposed by this chapter, and

"(iii) any foreign person or entity.

"(B) EXCEPTIONS FOR CERTAIN PROPERTY SUBJECT TO UNITED STATES TAX AND USED BY FOREIGN PERSON OR ENTITY.—

"(i) INCOME FROM PROPERTY SUBJECT TO UNITED STATES TAX.—Clause (iii) of subparagraph (A) shall not apply with respect to any property if more than 50 percent of the gross income for the taxable year derived by the foreign person or entity from the use of such property is—

"(I) subject to tax under this chapter, or

"(II) included under section 951 in the gross income of a United States shareholder for the taxable year with or within which ends the taxable year of the controlled foreign corporation in which such income was derived.

For purposes of the preceding sentence, any exclusion or exemption shall not apply for purposes of determining the amount of the gross income so derived, but shall apply for purposes of determining the portion of such gross income subject to tax under this chapter.

"(ii) MOVIES AND SOUND RECORDINGS.—Clause (iii) of subparagraph (A) shall not apply with respect to any qualified film (as defined in section 48(k)(1)(B)) or any sound recording (as defined in section 48(r)(5)).

"(C) FOREIGN PERSON OR ENTITY.—For purposes of this paragraph, the term 'foreign person or entity' means—

"(i) any foreign government, any international organization, or any agency or instrumentality of any of the foregoing, and

"(ii) any person who is not a United States person.

Such term does not include any foreign partnership or other foreign pass-thru entity.

"(D) TREATMENT OF CERTAIN TAXABLE INSTRUMENTALITIES.—For purposes of this subsection, a corporation shall not be treated as an instrumentality of the United States or of any State or political subdivision thereof if—

"(i) all of the activities of such corporation are subject to tax under this chapter, and

"(ii) a majority of the board of directors of such corporation is not selected by the United States or any State or political subdivision thereof.

"(E) CERTAIN PREVIOUSLY TAX-EXEMPT ORGANIZATIONS.—

"(i) IN GENERAL.—For purposes of this subsection, an organization shall be treated as an organization described in subparagraph (A)(ii) with respect to any property (other than property held by such organization) if such organization was an organization (other than a cooperative described in section 521) exempt from tax imposed by this chapter at any time during the 5-year period ending on the date such property was first used by such organization. The preceding sentence and subparagraph (D)(ii) shall not apply to the Federal Home Loan Mortgage Corporation.

"(ii) ELECTION NOT TO HAVE CLAUSE (I) APPLY.—

"(I) IN GENERAL.—In the case of an organization formerly exempt from tax under section 501(a) as an organization described in section 501(c)(12), clause (i) shall not apply to such organization with respect to any property if such organization elects not to be exempt from tax under section 501(a) during the tax-exempt use period with respect to such property.

"(II) TAX-EXEMPT USE PERIOD.—For purposes of subclause (I), the term 'tax-exempt use period' means the period beginning with the taxable year in which the property described in subclause (I) is first used by the organization and ending with the close of the 15th taxable year following the last taxable year of the applicable recovery period of such property.

"(III) ELECTION.—Any election under subclause (I), once made, shall be irrevocable.

"(iii) TREATMENT OF SUCCESSOR ORGANIZATIONS.—Any organization which is engaged in activities substantially similar to those engaged in by a predecessor organization shall succeed to the treatment under this subparagraph of such predecessor organization.

"(iv) FIRST USED.—For purposes of this subparagraph, property shall be treated as first used by the organization—

"(I) when the property is first placed in service under a lease to such organization, or

"(II) in the case of property leased to (or held by) a partnership (or other pass-thru entity) in which the organization is a member, the later of when such property is first used by such partnership or pass-thru entity or when such organization is first a member of such partnership or pass-thru entity.

"(3) SPECIAL RULES FOR CERTAIN HIGH TECHNOLOGY EQUIPMENT.—

"(A) EXEMPTION WHERE LEASE TERM IS 5 YEARS OR LESS.—*For purposes of this section, the term 'tax-exempt use property' shall not include any qualified technological equipment if the lease to the tax-exempt entity has a lease term of 5 years or less.*

"(B) EXCEPTION FOR CERTAIN PROPERTY.—

"(i) IN GENERAL.—*For purposes of subparagraph (A), the term 'qualified technological equipment' shall not include any property leased to a tax-exempt entity if—*

"(I) *part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under section 103(a),*

"(II) *such lease occurs after a sale (or other transfer) of the property by, or lease of such property from, such entity (or related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease, or*

"(III) *such tax-exempt entity is the United States or any agency or instrumentality of the United States.*

"(ii) LEASEBACKS DURING 1ST 3 MONTHS OF USE NOT TAKEN INTO ACCOUNT.—*Subclause (II) of clause (i) shall not apply to any property which is leased within 3 months after the date such property is first used by the tax-exempt entity (or a related entity).*

"(4) RELATED ENTITIES.—*For purposes of this subsection—*

"(A)(i) *Each governmental unit and each agency or instrumentality of a governmental unit is related to each other such unit, agency, or instrumentality which directly or indirectly derives its powers, rights, and duties in whole or in part from the same sovereign authority.*

"(ii) *For purposes of clause (i), the United States, each State, and each possession of the United States shall be treated as a separate sovereign authority.*

"(B) *Any entity not described in subparagraph (A)(i) is related to any other entity if the 2 entities have—*

"(i) *significant common purposes and substantial common membership, or*

"(ii) *directly or indirectly substantial common direction or control.*

"(C)(i) *An entity is related to another entity if either entity owns (directly or through 1 or more entities) a 50 percent or greater interest in the capital or profits of the other entity.*

"(ii) *For purposes of clause (i), entities treated as related under subparagraph (A) or (B) shall be treated as 1 entity.*

"(D) *An entity is related to another entity with respect to a transaction if such transaction is part of an attempt by such entities to avoid the application of this subsection.*

"(5) TAX-EXEMPT USE OF PROPERTY LEASED TO PARTNERSHIPS, ETC., DETERMINED AT PARTNER LEVEL.—*For purposes of this subsection—*

"(A) In general.—In the case of any property which is leased to a partnership, the determination of whether any portion of such property is tax-exempt use property shall be made by treating each tax-exempt entity partner's proportionate share (determined under paragraph (6)(C)) of such property as being leased to such partner.

"(B) Other pass-thru entities; tiered entities.—Rules similar to the rules of subparagraph (A) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

"(C) Presumption with respect to foreign entities.—Unless it is otherwise established to the satisfaction of the Secretary, it shall be presumed that the partners of a foreign partnership (and the beneficiaries of any other foreign pass-thru entity) are persons who are not United States persons.

"(6) Treatment of property owned by partnerships, etc.—

"(A) In general.—For purposes of this subsection, if—

"(i) any property which (but for this subparagraph) is not tax-exempt use property is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, and

"(ii) any allocation to the tax-exempt entity of partnership items is not a qualified allocation,

an amount equal to such tax-exempt entity's proportionate share of such property shall (except as provided in paragraph (1)(D)) be treated as tax-exempt use property.

"(B) Qualified allocation.—For purposes of subparagraph (A), the term 'qualified allocation' means any allocation to a tax-exempt entity which—

"(i) is consistent with such entity's being allocated the same distributive share of each item of income, gain, loss, deduction, credit, and basis and such share remains the same during the entire period the entity is a partner in the partnership, and

"(ii) has substantial economic effect within the meaning of section 704(b)(2).

For purposes of this subparagraph, items allocated under section 704(c) shall not be taken into account.

"(C) Determination of proportionate share.—

"(i) In general.—For purposes of subparagraph (A), a tax-exempt entity's proportionate share of any property owned by a partnership shall be determined on the basis of such entity's share of partnership items of income or gain (excluding gain allocated under section 704(c)), whichever results in the largest proportionate share.

"(ii) Determination where allocations vary.—For purposes of clause (i), if a tax-exempt entity's share of partnership items of income or gain (excluding gain allocated under section 704(c)) may vary during the period such entity is a partner in the partnership, such

share shall be the highest share such entity may receive.

"(D) DETERMINATION OF WHETHER PROPERTY USED IN UNRELATED TRADE OR BUSINESS.—For purposes of this subsection, in the case of any property which is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, the determination of whether such property is used in an unrelated trade or business of such an entity shall be made without regard to section 514.

"(E) OTHER PASS-THRU ENTITIES; TIERED ENTITIES.—Rules similar to the rules of subparagraphs (A), (B), (C), and (D) shall also apply in the case of any pass-thru entity other than a partnership and in the case of tiered partnerships and other entities.

"(F) TREATMENT OF CERTAIN TAXABLE ENTITIES.—

"(i) IN GENERAL.—For purposes of this paragraph and paragraph (5), except as otherwise provided in this subparagraph, any tax-exempt controlled entity shall be treated as a tax-exempt entity.

"(ii) ELECTION.—If a tax-exempt controlled entity makes an election under this clause—

"(I) such entity shall not be treated as a tax-exempt entity for purposes of this paragraph and paragraph (5), and

"(II) any gain recognized by a tax-exempt entity on any disposition of an interest in such entity (and any dividend or interest received or accrued by a tax-exempt entity from such tax-exempt controlled entity) shall be treated as unrelated business taxable income for purposes of section 511.

Any such election shall be irrevocable and shall bind all tax-exempt entities holding interests in such tax-exempt controlled entity. For purposes of subclause (II), there shall only be taken into account dividends which are properly allocable to income of the tax-exempt controlled entity which was not subject to tax under this chapter.

"(iii) TAX-EXEMPT CONTROLLED ENTITY.—

"(I) IN GENERAL.—The term 'tax-exempt controlled entity' means any corporation (which is not a tax-exempt entity determined without regard to this subparagraph and paragraph (2)(E)) if 50 percent or more (in value) of the stock in such corporation is held by 1 or more tax-exempt entities (other than a foreign person or entity).

"(II) Only 5-percent shareholders taken into account in case of publicly traded stock.—For purposes of subclause (I), in the case of a corporation the stock of which is publicly traded on an established securities market, stock held by a tax-exempt entity shall not be taken into account unless such entity holds at least 5 percent (in value) of the stock in such corporation. For pur-

poses of this subclause, related entities (within the meaning of paragraph (4)) shall be treated as 1 entity.

"(III) Section 318 to apply.—For purposes of this clause, a tax-exempt entity shall be treated as holding stock which it holds through application of section 318 (determined without regard to the 50-percent limitation contained in subsection (a)(2)(C) thereof).

"(G) REGULATIONS.—For purposes of determining whether there is a qualified allocation under subparagraph (B), the regulations prescribed under paragraph (8) for purposes of this paragraph—

"(i) shall set forth the proper treatment for partnership guaranteed payments, and

"(ii) may provide for the exclusion or segregation of items.

"(7) LEASE.—For purposes of this subsection, the term 'lease' includes any grant of a right to use property.

"(8) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

"(i) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) CLASS LIFE.—

"(A) IN GENERAL.—Except as provided in this section, the term 'class life' means the class life (if any) which would be applicable with respect to any property as of January 1, 1986, under subsection (m) of section 167 (determined without regard to paragraph (4) thereof and as if the taxpayer had made an election under such subsection).

"(B) SECRETARIAL AUTHORITY.—The Secretary, through an office established in the Treasury—

"(i) shall monitor and analyze actual experience with respect to all depreciable assets, and

"(ii) except in the case of residential rental property or nonresidential real property—

"(I) may prescribe a new class life for any property,

"(II) in the case of assigned property, may modify any assigned item, or

"(III) may prescribe a class life for any property which does not have a class life within the meaning of subparagraph (A).

Any class life or assigned item prescribed or modified under the preceding sentence shall reasonably reflect the anticipated useful life, and the anticipated decline in value over time, of the property to the industry or other group.

"(C) EFFECT OF MODIFICATION.—Any class life or assigned item with respect to any property prescribed or modified under subparagraph (B) shall be used in classifying such property under subsection (e) and in applying subsection (g).

"(D) NO MODIFICATION OF ASSIGNED PROPERTY BEFORE JANUARY 1, 1992.—

"(i) In general.—Except as otherwise provided in this subparagraph, the Secretary may not modify an assigned item under subparagraph (B)(ii)(II) for any assigned property which is placed in service before January 1, 1992.

"(ii) Exception for shorter class life.—In the case of assigned property which is placed in service before January 1, 1992, and for which the assigned item reflects a class life which is shorter than the class life under subparagraph (A), the Secretary may modify such assigned item under subparagraph (B)(ii)(II) if such modification results in an item which reflects a shorter class life than such assigned item.

"(E) Assigned property and item.—For purposes of this paragraph—

"(i) Assigned property.—The term 'assigned property' means property for which a class life, classification, or recovery period is assigned under subsection (e)(3) or subparagraph (B), (C), or (D) of subsection (g)(3).

"(ii) Assigned item.—The term 'assigned item' means the class life, classification, or recovery period assigned under subsection (e)(3) or subparagraph (B), (C), or (D) of subsection (g)(3).

"(2) Qualified technological equipment.—

"(A) In general.—The term 'qualified technological equipment' means—

"(i) any computer or peripheral equipment,

"(ii) any high technology telephone station equipment installed on the customer's premises, and

"(iii) any high technology medical equipment.

"(B) Computer or peripheral equipment defined.—For purposes of this paragraph—

"(i) In general.—The term 'computer or peripheral equipment' means—

"(I) any computer, and

"(II) any related peripheral equipment.

"(ii) Computer.—The term 'computer' means a programmable electronically activated device which—

"(I) is capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention, and

"(II) consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities.

"(iii) Related peripheral equipment.—The term 'related peripheral equipment' means any auxiliary machine (whether on-line or off-line) which is designed to be placed under the control of the central processing unit of a computer.

"(iv) Exceptions.—The term 'computer or peripheral equipment' shall not include—

"(I) any equipment which is an integral part of other property which is not a computer,

"(II) typewriters, calculators, adding and accounting machines, copiers, duplicating equipment, and similar equipment, and

"(III) equipment of a kind used primarily for amusement or entertainment of the user.

"(C) HIGH TECHNOLOGY MEDICAL EQUIPMENT.—For purposes of this paragraph, the term 'high technology medical equipment' means any electronic, electromechanical, or computer-based high technology equipment used in the screening, monitoring, observation, diagnosis, or treatment of patients in a laboratory, medical, or hospital environment.

"(3) LEASE TERM.—

"(A) IN GENERAL.—In determining a lease term—

"(i) there shall be taken into account options to renew, and

"(ii) 2 or more successive leases which are part of the same transaction (or a series of related transactions) with respect to the same or substantially similar property shall be treated as 1 lease.

"(B) SPECIAL RULE FOR FAIR RENTAL OPTIONS ON NONRESIDENTIAL REAL PROPERTY OR RESIDENTIAL RENTAL PROPERTY.—For purposes of clause (i) of subparagraph (A), in the case of nonresidential real property or residential rental property, there shall not be taken into account any option to renew at fair market value, determined at the time of renewal.

"(4) GENERAL ASSET ACCOUNTS.—Under regulations, a taxpayer may maintain 1 or more general asset accounts for any property to which this section applies. Except as provided in regulations, all proceeds realized on any disposition of property in a general asset account shall be included in income as ordinary income.

"(5) CHANGES IN USE.—The Secretary shall, by regulations, provide for the method of determining the deduction allowable under section 167(a) with respect to any tangible property for any taxable year (and the succeeding taxable years) during which such property changes status under this section but continues to be held by the same person.

"(6) TREATMENTS OF ADDITIONS OR IMPROVEMENTS TO PROPERTY.—In the case of any addition to (or improvement of) any property—

"(A) any deduction under subsection (a) for such addition or improvement shall be computed in the same manner as the deduction for such property would be computed if such property had been placed in service at the same time as such addition or improvement, and

"(B) the applicable recovery period for such addition or improvement shall begin on the later of—

"(i) the date on which such addition (or improvement) is placed in service, or

"(ii) the date on which the property with respect to which such addition (or improvement) was made is placed in service.

"(7) Treatment of certain transferees.—

"(A) In general.—In the case of any property transferred in a transaction described in subparagraph (B), the transferee shall be treated as the transferor for purposes of computing the depreciation deduction determined under this section with respect to so much of the basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor.

"(B) Transactions covered.—The transactions described in this subparagraph are any transaction described in section 332, 351, 361, 371(a), 374(a), 721, or 731. Subparagraph (A) shall not apply in the case of a termination of a partnership under section 708(b)(1)(B).

"(C) Property reacquired by the taxpayer.—Under regulations, property which is disposed of and then reacquired by the taxpayer shall be treated for purposes of computing the deduction allowable under subsection (a) as if such property had not been disposed of.

"(D) Exception.—This paragraph shall not apply to any transaction to which subsection (f)(5) applies (relating to churning transactions).

"(8) Treatment of leasehold improvements.—In the case of any building erected (or improvements made) on leased property, if such building or improvement is property to which this section applies, the depreciation deduction shall be determined under the provisions of this section.

"(9) Normalization rules.—

"(A) In general.—In order to use a normalization method of accounting with respect to any public utility property for purposes of subsection (f)(2)—

"(i) the taxpayer must, in computing its tax expense for purposes of establishing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, use a method of depreciation with respect to such property that is the same as, and a depreciation period for such property that is no shorter than, the method and period used to compute its depreciation expense for such purposes; and

"(ii) if the amount allowable as a deduction under this section with respect to such property differs from the amount that would be allowable as a deduction under section 167 (determined without regard to section 167(l)) using the method (including the period, first and last year convention, and salvage value) used to compute regulated tax expense under clause (i), the taxpayer must make adjustments to a reserve to reflect the deferral of taxes resulting from such difference.

"(B) Use of inconsistent estimates and projections, etc.—

"(i) In general.—One way in which the requirements of subparagraph (A) are not met is if the taxpayer, for ratemaking purposes, uses a procedure or adjustment which is inconsistent with the requirements of subparagraph (A).

"(ii) USE OF INCONSISTENT ESTIMATES AND PROJECTIONS.—The procedures and adjustments which are to be treated as inconsistent for purposes of clause (i) shall include any procedure or adjustment for ratemaking purposes which uses an estimate or projection of the taxpayer's tax expense, depreciation expense, or reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or projection is also used, for ratemaking purposes, with respect to the other 2 such items and with respect to the rate base.

"(iii) REGULATORY AUTHORITY.—The Secretary may by regulations prescribe procedures and adjustments (in addition to those specified in clause (ii)) which are to be treated as inconsistent for purposes of clause (i).

"(C) PUBLIC UTILITY PROPERTY WHICH DOES NOT MEET NORMALIZATION RULES.—In the case of any public utility property to which this section does not apply by reason of subsection (f)(2), the allowance for depreciation under section 167(a) shall be an amount computed using the method and period referred to in subparagraph (A)(i).

"(10) PUBLIC UTILITY PROPERTY.—The term 'public utility property' has the meaning given such term by section 167(l)(3)(A).

"(11) RESEARCH AND EXPERIMENTATION.—The term 'research and experimentation' has the same meaning as the term research and experimental has under section 174.

"(12) SECTION 1245 AND 1250 PROPERTY.—The terms 'section 1245 property' and 'section 1250 property' have the meanings given such terms by sections 1245(a)(3) and 1250(c), respectively."

(b) SYSTEM USED FOR PURPOSES OF EARNINGS AND PROFITS.—Paragraph (3) of section 312(k) is amended to read as follows:

"(3) EXCEPTION FOR TANGIBLE PROPERTY.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of tangible property to which section 168 applies, the adjustment to earnings and profits for depreciation for any taxable year shall be determined under the alternative depreciation system (within the meaning of section 168(g)(2)).

"(B) TREATMENT OF AMOUNTS DEDUCTIBLE UNDER SECTION 179.—For purposes of computing the earnings and profits of a corporation, any amount deductible under section 179 shall be allowed as a deduction ratably over the period of 5 taxable years (beginning with the taxable year for which such amount is deductible under section 179)."

(c) CONTINUATION OF RULES RELATING TO MOTOR VEHICLE OPERATING LEASES.—Section 7701 is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) MOTOR VEHICLE OPERATING LEASES.—

"(1) IN GENERAL.—For purposes of this title, in the case of a qualified motor vehicle operating agreement which contains a terminal rental adjustment clause—

"(A) such agreement shall be treated as a lease if (but for such terminal rental adjustment clause) such agreement would be treated as a lease under this title, and

"(B) the lessee shall not be treated as the owner of the property subject to an agreement during any period such agreement is in effect.

"(2) Qualified motor vehicle operating agreement defined.—For purposes of this subsection—

"(A) In general.—The term 'qualified motor vehicle operating agreement' means any agreement with respect to a motor vehicle (including a trailer) which meets the requirements of subparagraphs (B), (C), and (D) of this paragraph.

"(B) Minimum liability of lessor.—An agreement meets the requirements of this subparagraph if under such agreement the sum of—

"(i) the amount the lessor is personally liable to repay, and

"(ii) the net fair market value of the lessor's interest in any property pledged as security for property subject to the agreement,

equals or exceeds all amounts borrowed to finance the acquisition of property subject to the agreement. There shall not be taken into account under clause (ii) any property pledged which is property subject to the agreement or property directly or indirectly financed by indebtedness secured by property subject to the agreement.

"(C) Certification by lessee; notice of tax ownership.—An agreement meets the requirements of this subparagraph if such agreement contains a separate written statement separately signed by the lessee—

"(i) under which the lessee certifies, under penalty of perjury, that it intends that more than 50 percent of the use of the property subject to such agreement is to be in a trade or business of the lessee, and

"(ii) which clearly and legibly states that the lessee has been advised that it will not be treated as the owner of the property subject to the agreement for Federal income tax purposes.

"(D) Lessor must have no knowledge that certification is false.—An agreement meets the requirements of this subparagraph if the lessor does not know that the certification described in subparagraph (C)(i) is false.

"(3) Terminal rental adjustment clause defined.—

"(A) In general.—For purposes of this subsection, the term 'terminal rental adjustment clause' means a provision of an agreement which permits or requires the rental price to be adjusted upward or downward by reference to the amount realized by the lessor under the agreement upon sale or other disposition of such property.

"(B) Special rule for lessee dealers.—The term 'terminal rental adjustment clause' also includes a provision of an agreement which requires a lessee who is a dealer in motor vehicles to purchase the motor vehicle for a predetermined price and then resell such vehicle where such provi-

sion achieves substantially the same results as a provision described in subparagraph (A).”

(d) Technical and Conforming Amendments.—

(1) Section 167.—Paragraph (4) of section 167(m) (relating to termination of class lives) is amended to read as follows:

“(4) Termination.—This subsection shall not apply with respect to any property to which section 168 applies.”

(2) Section 178.—

(A) Section 178 is amended to read as follows:

“SEC. 178. AMORTIZATION OF COST OF ACQUIRING A LEASE.

“(a) General Rule.—In determining the amount of the deduction allowable to a lessee of a lease for any taxable year for amortization under section 167, 169, 179, 185, 190, 193, or 194 in respect of any cost of acquiring the lease, the term of the lease shall be treated as including all renewal options (and any other period for which the parties reasonably expect the lease to be renewed) if less than 75 percent of such cost is attributable to the period of the term of the lease remaining on the date of its acquisition.

“(b) Certain Periods Excluded.—For purposes of subsection (a), in determining the period of the term of the lease remaining on the date of acquisition, there shall not be taken into account any period for which the lease may subsequently be renewed, extended, or continued pursuant to an option exercisable by the lessee.”

(B) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 178 and inserting in lieu thereof the following new item:

“Sec. 178. Amortization of cost of acquiring a lease.”

(3) Section 179.—Paragraph (8) of section 179(d) is amended to read as follows:

“(8) Treatment of partnerships and S corporations.—In the case of a partnership, the limitations of subsection (b) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.”

(4) Section 280F.—

(A) Paragraph (2) of section 280F(a) (relating to depreciation) is amended—

(i) by striking out clauses (i) and (ii) of subparagraph (A) thereof and inserting in lieu thereof the following new clauses:

“(i) $2,560 for the 1st taxable year in the recovery period,

“(ii) $4,100 for the 2nd taxable year in the recovery period,

“(iii) $2,450 for the 3rd taxable year in the recovery period, and

“(iv) $1,475 for each succeeding taxable year in the recovery period.”, and

(ii) by striking out “$4,800” each place it appears in subparagraph (B) thereof and inserting in lieu thereof “$1,475”.

(B) Subparagraph (A) of section 280F(b)(3) (relating to recapture) is amended by striking out "the straight line method over the earnings and profits life" and inserting in lieu thereof "section 168(g) (relating to alternative depreciation system)".

(C) Paragraph (4) of section 280F(b) (relating to definitions) is amended to read as follows:

"(4) PROPERTY PREDOMINANTLY USED IN QUALIFIED BUSINESS USE.—For purposes of this subsection, property shall be treated as predominantly used in a qualified business use for any taxable year if the business use percentage for such taxable year exceeds 50 percent."

(D) Paragraph (4) of section 280F(c) is amended by striking out "section 168(j)(6)(B)" and inserting in lieu thereof "section 168(i)(3)(A)".

(E) Paragraph (1) of section 280F(d) is amended by striking out "recovery deduction" and inserting in lieu thereof "depreciation deduction".

(F) Paragraph (2) of section 280F(d) is amended—

(i) by striking out "recovery deduction" and inserting in lieu thereof "depreciation deduction", and

(ii) by striking out "use described in section 168(c)(1) (defining recovery property)" and inserting in lieu thereof "use in a trade or business (including the holding for the production of income)".

(G) Clause (iv) of section 280F(d)(4)(A) is amended by striking out "section 168(j)(5)(D)" and inserting in lieu thereof "section 168(i)(2)(B)".

(H) Paragraph (8) of section 280F(d) (defining unrecovered basis) is amended to read as follows:

"(8) UNRECOVERED BASIS.—For purposes of subsection (a)(2), the term 'unrecovered basis' means the adjusted basis of the passenger automobile determined after the application of subsection (a) and as if all use during the recovery period were use in a trade or business (including the holding of property for the production of income)."

(I) Paragraph (10) of section 280F(d) is amended by striking out ", notwithstanding any regulations prescribed under section 168(f)(7),".

(J) Paragraph (2) of section 280F(b) is amended by striking out "the straight line method over the earnings and profits life for such property" and inserting in lieu thereof "section 168(g) (relating to alternative depreciation system)".

(K) Subsections (a) and (b) of section 280F are amended by striking out "recovery deduction" each place it appears and inserting in lieu thereof "depreciation deduction".

(5) SECTION 291.—

(A) Subparagraph (A) of section 291(a)(1) is amended by striking out "or section 1245 recovery property".

(B) Paragraph (1) of section 291(c) is amended to read as follows:

"(1) ACCELERATED COST RECOVERY DEDUCTION.—Section 168 shall apply with respect to that portion of the basis of any prop-

erty not taken into account under section 169 by reason of subsection (a)(5)."

(C) Section 291(e)(2) is amended by striking out ", 'section 1245 recovery property'," and ", section 1245(a)(5),".

(6) SECTION 312.—Paragraph (4) of section 312(k) is amended by striking out the last sentence.

(7) SECTION 465.—

(A) Subparagraph (C) of section 465(b)(3) is amended to read as follows:

"(C) RELATED PERSON.—For purposes of this subsection, a person (hereinafter in this paragraph referred to as the 'related person') is related to any person if—

"(i) the related person bears a relationship to such person specified in section 267(b) or section 707(b)(1), or

"(ii) the related person and such person are engaged in trades or business under common control (within the meaning of subsections (a) and (b) of section 52).

For purposes of clause (i), in applying section 267(b) or 707(b)(1), '10 percent' shall be substituted for '50 percent'."

(B) Section 46(c)(8)(D)(v) is amended by striking out "section 168(e)(4)" and inserting in lieu thereof "section 465(b)(3)(C)".

(C) Section 4162(c)(3) is amended by striking out "section 168(e)(4)(D)" and inserting in lieu thereof "section 465(b)(3)(C)".

(8) SECTION 467.—

(A) Paragraph (3) of section 467(e) is amended to read as follows:

"(3) STATUTORY RECOVERY PERIOD.—

"(A) IN GENERAL.—

"In the case of:	*The statutory recovery period is:*
3-year property	*3 years*
5-year property	*5 years*
7-year property	*7 years*
10-year property	*10 years*
15-year and 20-year property	*15 years*
Residential rental property and nonresidential real property	*19 years.*

"(B) SPECIAL RULE FOR PROPERTY NOT DEPRECIABLE UNDER SECTION 168.—In the case of property to which section 168 does not apply, subparagraph (A) shall be applied as if section 168 applies to such property."

(B) Paragraph (5) of section 467(e) (defining related person) is amended by striking out "section 168(e)(4)(D)" and inserting in lieu thereof "section 465(b)(3)(C)".

(9) SECTION 514.—Subclause (II) of section 514(c)(9)(B)(vi) (relating to real property acquired by a qualified organization) is amended by striking out "section 168(j)(9)" and inserting in lieu thereof "section 168(h)(6)".

(10) SECTION 751.—Subsection (c) of section 751 (defining unrealized receivables) is amended by striking out "section 1245 recovery property (as defined in section 1245(a)(5)),".

(11) SECTION 1245.—

(A) Paragraph (1) of section 1245(a) (relating to gain from dispositions of certain depreciable property) is amended by striking out "during a taxable year beginning after December 31, 1962, or section 1245 recovery property is disposed of after December 31, 1980,".

(B) Paragraph (2) of section 1245(a) (defining recomputed basis) is amended to read as follows:

"(2) RECOMPUTED BASIS.—For purposes of this section—

"(A) IN GENERAL.—The term 'recomputed basis' means, with respect to any property, its adjusted basis recomputed by adding thereto all adjustments reflected in such adjusted basis on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for depreciation or amortization.

"(B) TAXPAYER MAY ESTABLISH AMOUNT ALLOWED.—For purposes of subparagraph (A), if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed for depreciation or amortization for any period was less than the amount allowable, the amount added for such period shall be the amount allowed.

"(C) CERTAIN DEDUCTIONS TREATED AS AMORTIZATION.—Any deduction allowable under section 179, 190, or 193 shall be treated as if it were a deduction allowable for amortization."

(C) Paragraph (3) of section 1245(a) (defining section 1245 property) is amended by striking out subparagraph (C) and by redesignating subparagraphs (D), (E), and (F) as subparagraphs (C), (D), and (E), respectively.

(D) Subsection (a) of section 1245 is amended by striking out paragraphs (5) and (6).

(12) SECTION 4162.—Paragraph (3) of section 4162(c) (defining related person) is amended by striking out "section 168(e)(4)(D)" and inserting in lieu thereof "section 465(b)(3)(C)".

(13) SECTION 6111.—Clause (ii) of section 6111(c)(3)(B) (relating to certain borrowed amounts excluded) is amended by striking out "section 168(e)(4)" and inserting in lieu thereof "section 465(b)(3)(C)".

(14) SECTION 7701.—

(A) Subparagraph (A) of section 7701(e)(4) is amended by striking out "section 168(j)" and inserting in lieu thereof "section 168(h)".

(B) Paragraph (5) of section 7701(e) (relating to exception for certain low-income housing) is amended by striking out "low-income housing (section 168(c)(2)(F))" and inserting in lieu thereof "property described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B) (relating to low-income housing)".

SEC. 202. EXPENSING OF DEPRECIABLE ASSETS.

(a) LIMITATIONS ON EXPENSING.—Subsection (b) of section 179 (relating to election to expense certain depreciable assets) is amended to read as follows:

"(b) LIMITATIONS.—

"(1) Dollar limitation.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $10,000.

"(2) Reduction in limitation.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property placed in service during such taxable year exceeds $200,000.

"(3) Limitation based on income from trade or business.—

"(A) In general.—The aggregate cost of section 179 property taken into account under subsection (a) for any taxable year shall not exceed the aggregate amount of taxable income of the taxpayer for such taxable year which is derived from the active conduct by the taxpayer of any trade or business during such taxable year.

"(B) Carryover of unused cost.—The amount of any cost which (but for subparagraph (A)) would have been allowed as a deduction under subsection (a) for any taxable year shall be carried to the succeeding taxable year and added to the amount allowable as a deduction under subsection (a) for such succeeding taxable year.

"(C) Computation of taxable income.—For purposes of this paragraph, taxable income derived from the conduct of a trade or business shall be computed without regard to the cost of any section 179 property.

"(4) Married individuals filing separately.—In the case of a husband and wife filing separate returns for the taxable year—

"(A) such individuals shall be treated as 1 taxpayer for purposes of paragraphs (1) and (2), and

"(B) unless such individuals elect otherwise, 50 percent of the cost which may be taken into account under subsection (a) for such taxable year (before application of paragraph (3)) shall be allocated to each such individual."

(b) Section 179 property.—Paragraph (1) of section 179(d) (defining section 179 property) is amended by inserting "in the active conduct of" after "purchase for use".

(c) Recapture.—Section 179(d)(10) (relating to recapture in certain cases) is amended by striking out all that follows "at any time" and inserting in lieu thereof a period.

SEC. 203. EFFECTIVE DATES; GENERAL TRANSITIONAL RULES.

(a) General Effective Dates.—

(1) Section 201.—

(A) In general.—Except as provided in this section, section 204, and section 251(d), the amendments made by section 201 shall apply to property placed in service after December 31, 1986, in taxable years ending after such date.

(B) Election to have amendments made by section 201 apply.—A taxpayer may elect (at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe) to have the amendments made by section 201 apply to any property placed in service after July 31, 1986, and before January 1, 1987.

(2) SECTION 202.—The amendments made by section 202 shall apply to property placed in service after December 31, 1986, in taxable years ending after such date.

(b) GENERAL TRANSITIONAL RULE.—

(1) IN GENERAL.—The amendments made by section 201 shall not apply to—

(A) any property which is constructed, reconstructed, or acquired by the taxpayer pursuant to a written contract which was binding on March 1, 1986,

(B) property which is constructed or reconstructed by the taxpayer if—

(i) the lesser of (I) $1,000,000, or (II) 5 percent of the cost of such property has been incurred or committed by March 1, 1986, and

(ii) the construction or reconstruction of such property began by such date, or

(C) an equipped building or plant facility if construction has commenced as of March 1, 1986, pursuant to a written specific plan and more than one-half of the cost of such equipped building or facility has been incurred or committed by such date.

(2) REQUIREMENT THAT CERTAIN PROPERTY BE PLACED IN SERVICE BEFORE CERTAIN DATE.—

(A) IN GENERAL.—Paragraph (1) and section 204(a) (other than paragraph (8) or (12) thereof) shall not apply to any property unless such property has a class life of at least 7 years and is placed in service before the applicable date determined under the following table:

In the case of property with a class life of:	The applicable date is:
At least 7 but less than 20 years	January 1, 1989
20 years or more	January 1, 1991.

(B) RESIDENTIAL RENTAL AND NONRESIDENTIAL REAL PROPERTY.—In the case of residential rental property and nonresidential real property, the applicable date is January 1, 1991.

(C) CLASS LIVES.—For purposes of subparagraph (A)—

(i) the class life of property to which section 168(g)(3)(B) of the Internal Revenue Code of 1986 (as added by section 201) shall be the class life in effect on January 1, 1986, except that computer-based telephone central office switching equipment described in section 168(e)(3)(B)(iii) of such Code shall be treated as having a class life of 6 years,

(ii) property described in section 204(a) shall be treated as having a class life of 20 years, and

(iii) property with no class life shall be treated as having a class life of 12 years.

(D) SUBSTITUTION OF APPLICABLE DATES.—If any provision of this Act substitutes a date for an applicable date, this paragraph shall be applied by using such date.

(3) PROPERTY QUALIFIES IF SOLD AND LEASED BACK IN 3 MONTHS.—Property shall be treated as meeting the requirements of paragraphs (1) and (2) or section 204(a) with respect to any

taxpayer if such property is acquired by the taxpayer from a person—

(A) in whose hands such property met the requirements of paragraphs (1) and (2) or section 204(a), or

(B) who placed the property in service before January 1, 1987,

and such property is leased back by the taxpayer to such person not later than the earlier of the applicable date under paragraph (2) or the day which is 3 months after such property was placed in service.

(4) PLANT FACILITY.—For purposes of paragraph (1), the term "plant facility" means a facility which does not include any building (or with respect to which buildings constitute an insignificant portion) and which is—

(A) a self-contained single operating unit or processing operation,

(B) located on a single site, and

(C) identified as a single unitary project as of March 1, 1986.

(c) PROPERTY FINANCED WITH TAX-EXEMPT BONDS.—

(1) IN GENERAL.—Subparagraph (C) of section 168(g)(1) of the Internal Revenue Code of 1986 (as added by this Act) shall apply to property placed in service after December 31, 1986, in taxable years ending after such date, to the extent such property is financed by the proceeds of an obligation (including a refunding obligation) issued after March 1, 1986.

(2) EXCEPTIONS.—

(A) CONSTRUCTION OR BINDING AGREEMENTS.—Subparagraph (C) of section 168(g)(1) of such Code (as so added) shall not apply to obligations with respect to a facility—

(i)(I) the original use of which commences with the taxpayer, and the construction, reconstruction, or rehabilitation of which began before March 2, 1986, and was completed on or after such date,

(II) with respect to which a binding contract to incur significant expenditures for construction, reconstruction, or rehabilitation was entered into before March 2, 1986, and some of such expenditures are incurred on or after such date, or

(III) acquired on or after March 2, 1986, pursuant to a binding contract entered into before such date, and

(ii) described in an inducement resolution or other comparable preliminary approval adopted by the issuing authority (or by a voter referendum) before March 2, 1986.

(B) REFUNDING.—

(i) IN GENERAL.—Except as provided in clause (ii), in the case of property placed in service after December 31, 1986, which is financed by the proceeds of an obligation which is issued solely to refund another obligation which was issued before March 2, 1986, subparagraph (C) of section 168(g)(1) of such Code (as so added) shall apply only with respect to an amount equal to the basis

in such property which has not been recovered before the date such refunded obligation is issued.

(ii) Significant expenditures.—In the case of facilities the original use of which commences with the taxpayer and with respect to which significant expenditures are made before January 1, 1987, subparagraph (C) of section 168(g)(1) of such Code (as so added) shall not apply with respect to such facilities to the extent such facilities are financed by the proceeds of an obligation issued solely to refund another obligation which was issued before March 2, 1986.

(C) Facilities.—In the case of an inducement resolution or other comparable preliminary approval adopted by an issuing authority before March 2, 1986, for purposes of subparagraphs (A) and (B)(ii) with respect to obligations described in such resolution, the term "facilities" means the facilities described in such resolution.

(D) Significant expenditures.—For purposes of this paragraph, the term "significant expenditures" means expenditures greater than 10 percent of the reasonably anticipated cost of the construction, reconstruction, or rehabilitation of the facility involved.

(d) Mid-Quarter Convention.—In the case of any taxable year in which property to which the amendments made by section 201 do not apply is placed in service, such property shall be taken into account in determining whether section 168(d)(3) of the Internal Revenue Code of 1986 (as added by section 201) applies for such taxable year to property to which such amendments apply.

(e) Normalization Requirements.—

(1) In general.—A normalization method of accounting shall not be treated as being used with respect to any public utility property for purposes of section 167 or 168 of the Internal Revenue Code of 1986 if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.

(2) Definitions.—For purposes of this subsection—

(A) Excess tax reserve.—The term "excess tax reserve" means the excess of—

(i) the reserve for deferred taxes (as described in section 167(l)(3)(G)(ii) or 168(e)(3)(B)(ii) of the Internal Revenue Code of 1954 as in effect on the day before the date of the enactment of this Act), over

(ii) the amount which would be the balance in such reserve if the amount of such reserve were determined by assuming that the corporate rate reductions provided in this Act were in effect for all prior periods.

(B) Average rate assumption method.—The average rate assumption method is the method under which the excess in the reserve for deferred taxes is reduced over the remaining lives of the property as used in its regulated books of account which gave rise to the reserve for deferred taxes. Under such method, if timing differences for the

property reverse, the amount of the adjustment to the reserve for the deferred taxes is calculated by multiplying—

(i) the ratio of the aggregate deferred taxes for the property to the aggregate timing differences for the property as of the beginning of the period in question, by

(ii) the amount of the timing differences which reverse during such period.

SEC. 204. ADDITIONAL TRANSITIONAL RULES.

(a) OTHER TRANSITIONAL RULES.—

(1) URBAN RENOVATION PROJECTS.—

(A) IN GENERAL.—The amendments made by section 201 shall not apply to any property which is an integral part of any qualified urban renovation project.

(B) QUALIFIED URBAN RENOVATION PROJECT.—For purposes of subparagraph (A), the term "qualified urban renovation project" means any project—

(i) described in subparagraph (C), (D), (E), or (G) which before March 1, 1986, was publicly announced by a political subdivision of a State for a renovation of an urban area within its jurisdiction,

(ii) described in subparagraph (C), (D) or (G) which before March 1, 1986, was identified as a single unitary project in the internal financing plans of the primary developer of the project, and

(iii) described in subparagraph (C) or (D), which is not substantially modified on or after March 1, 1986.

(C) PROJECT WHERE AGREEMENT ON DECEMBER 19, 1984.—A project is described in this subparagraph if—

(i) a political subdivision granted on July 11, 1985, development rights to the primary developer-purchaser of such project, and

(ii) such project was the subject of a development agreement between a political subdivision and a bridge authority on December 19, 1984.

For purposes of this subparagraph, subsection (b)(2) shall be applied by substituting "January 1, 1994" for "January 1, 1991".

(D) CERTAIN ADDITIONAL PROJECTS.—A project is described in this subparagraph if it is described in any of the following clauses of this subparagraph and the primary developer of all such projects is the same person:

(i) A project is described in this clause if the development agreement with respect thereto was entered into during April 1984 and the estimated cost of the project is approximately $194,000,000.

(ii) A project is described in this clause if the development agreement with respect thereto was entered into during May 1984 and the estimated cost of the project is approximately $190,000,000.

(iii) A project is described in this clause if the project has an estimated cost of approximately $92,000,000 and

at least $7,000,000 was spent before September 26, 1985, with respect to such project.

(iv) A project is described in this clause if the estimately project cost is approximately $39,000,000 and at least $2,000,000 of construction cost for such project were incurred before September 26, 1985.

(v) A project is described in this clause if the development agreement with respect thereto was entered into before September 26, 1985, and the estimated cost of the project is approximately $150,000,000.

(vi) A project is described in this clause if the board of directors of the primary developer approved such project in December 1982, and the estimated cost of such project is approximately $107,000,000.

(vii) A project is described in this clause if the board of directors of the primary developer approved such project in December 1982, and the estimated cost of such project is approximately $59,000,000.

(viii) A project is described in this clause if the Board of Directors of the primary developer approved such project in December 1983, following selection of the developer by a city council on September 26, 1983, and the estimated cost of such project is approximately $107,000,000."

(E) Project where plan confirmed on October 4, 1984.—A project is described in this subparagraph if—

(i) a State or an agency, instrumentality, or political subdivision thereof approved the filing of a general project plan on June 18, 1981, and on October 4, 1984, a State or an agency, instrumentality, or political subdivision thereof confirmed such plan,

(ii) the project plan as confirmed on October 4, 1984, included construction or renovation of office buildings, a hotel, a trade mart, theaters, and a subway complex, and

(iii) significant segments of such project were the subject of one or more conditional designations granted by a State or an agency, instrumentality, or political subdivision thereof to one or more developers before January 1, 1985.

The preceding sentence shall apply with respect to a property only to the extent that a building on such property site was identified as part of the project plan before September 26, 1985, and only to the extent that the size of the building on such property site was not substantially increased by reason of a modification to the project plan with respect to such property on or after such date. For purposes of this subparagraph, subsection (b)(2) shall be applied by substituting "January 1, 1998" for "January 1, 1991."

(F) A project is described in this paragraph if it is a sports and entertainment facility which—

(i) is to be used by both a National Hockey League team and a National Basketball Association team;

(ii) is to be constructed on a platform utilizating air rights over land acquired by a state authority and identified as Site B in a report dated May 30, 1984, prepared for a state urban development corporation; and

(iii) is eligible for real property tax, and power and energy benefits pursuant to the provisions of state legislation approved and effective July 7, 1982, or

(iv) the mixed-use development is—

(I) to be constructed above a public railroad station utilized by the national railroad passenger corporation and commuter railroads serving two states; and

(II) will include the reconstruction of such station so as to make it a more efficient transportation center and to better integrate the station with the development above, such reconstruction plans to be prepared in cooperation with a state transportation authority.

For purposes of this subparagraph, subsection (b)(2) shall be applied by substituting "January 1, 1993" for the applicable date that would otherwise apply.

(G) A project is described in this subparagraph if—

(i) an inducement resolution was passed on March 9, 1984, for the issuance of obligations with respect to such project,

(ii) such resolution was extended by resolutions passed on August 14, 1984, April 2, 1985, August 13, 1985, and July 8, 1986,

(iii) an application was submitted on January 31, 1984, for an Urban Development Action Grant with respect to such project, and

(iv) an Urban Development Action Grant was preliminarily approved for all or part of such project on July 3, 1986."

(H) A project is described in this subparagraph if it is a redevelopment project, with respect to which $10 million in industrial revenue bonds were approved by a State Development Finance Authority on January 15, 1986, a village transferred approximately $4 million of bond volume authority to the State in June 1986, and a binding Redevelopment Agreement was executed between a city and the develoment team on July 1, 1986.

(2) CERTAIN PROJECTS GRANTED FERC LICENSES, ETC.—The amendments made by section 201 shall not apply to any property which is part of a project—

(A) which is certified by the Federal Energy Regulatory Commission before March 2, 1986, as a qualifying facility for purposes of the Public Utility Regulatory Policies Act of 1978,

(B) which was granted before March 2, 1986, a hydroelectric license for such project by the Federal Energy Regulatory Commission, or

(C) which is a hydroelectric project of less than 80 megawatts that field an application for a permit exemption, or license with the Federal Energy Regulatory Commission before March 2, 1986.

(3) SUPPLY OR SERVICE CONTRACTS.—The amendments made by section 201 shall not apply to any property which is readily identifiable with and necessary to carry out a written supply or service contract, or agreement to lease, which was binding on March 1, 1986.

(4) PROPERTY TREATED UNDER PRIOR TAX ACTS.—The amendments made by section 201 shall not apply to property described in section 12(c)(2) or 31(g)(5) and 31(g)(17)(j) of the Tax Reform Act of 1984, to property described in section 209(d)(1)(B) of the Tax Equity and Fiscal Responsibility Act of 1982, as amended by the Tax Reform Act of 1984 and to property described in section 216(b)(3) of the Tax Equity and Fiscal Responsibility Act of 1982.

(5) SPECIAL RULES FOR PROPERTY INCLUDED IN MASTER PLANS OF INTEGRATED PROJECTS.—The amendments made by section 201 shall not apply to any property placed in service pursuant to a master plan which is clearly identifiable as of March 1, 1986, for any project described in any of the following subparagraphs of this paragraph:

(A) A project is described in this subparagraph if—

(i) the project involves production platforms for offshore drilling, oil and gas pipeline to shore, process and storage facilities, and a marine terminal, and

(ii) at least $900,000,000 of the costs of such project were incurred before September 26, 1985.

(B) A project is described in this subparagraph if—

(i) such project involves a fiber optic network of at least 20,000 miles, and

(ii) before September 26, 1985, construction commenced pursuant to the master plan and at least $85,000,000 was spent on construction.

(C) A project is described in this subparagraph if—

(i) such project passes through at least 10 States and involves intercity communication link (including one or more repeater sites terminals and junction stations for microwave transmissions, regenerators or fiber optics and other related equipment,

(ii) the lesser of $150,000,000 or 5 percent of the total project cost has been expended, incurred, or committed before March 2, 1986, by one or more taxpayers each of which is a member of the same affiliated group (as defined in section 1504(a)), and

(iii) such project consists of a comprehensive plan for meeting network capacity requirements as encompassed within either:

(I) a November 5, 1985, presentation made to and accepted by the Chairman of the Board and the president of the taxpayer, or

(II) the approvals by the Board of Directors of the parent company of the taxpayer on May 3,

1985, and September 22, 1985, and of the executive committee of said board on December 23, 1985.

(D) a project is described in this subparagraph if—

(i) such project is part of a flat rolled product modernization plan which was initially presented to the Board of Directors of the taxpayer on July 8, 1983,

(ii) such program will be carried out at 3 locations, and

(iii) such project will involve a total estimated minimum capital cost of at least $250,000,000.

(E) A project is described in this subparagraph if the project is being carried out by a corporation engaged in the production of paint, chemicals, fiberglass, and glass, and if—

(i) the project includes a production line which applied a thin coating to glass in the manufacture of energy efficient residential products, if approved by the management committee of the corporation on January 29, 1986,

(ii) the project is a turbogenerator which was approved by the president of such corporation and at least $1,000,000 of the cost of which was incurred or committed before such date,

(iii) the project is a waste-to-energy disposal system which was initiatlly approved by the management committee of the corporation on March 29, 1982, and at least $5,000,000 of the cost of which was incurred before September 26, 1985,

(iv) the project, which involves the expansion of an existing service facility and the addition of new lab facilities needed to accommodate topcoat and undercoat production needs of a nearby automotive assembly plant, was approved by the corporation's management committee on March 5, 1986, or

(v) the project is part of a facility to consolidate and modernize the silica production of such corporation and the project was approved by the president of such corporation on August 19, 1985.

(F) A project is described in this subparagraph if—

(i) such project involves a port terminal and oil pipeline extending generally from the area of Los Angeles, California, to the area of Midland, Texas, and

(ii) before September 26, 1985, there is a binding contract for dredging and channeling with respect thereto and a management contract with a construction manager for such project.

(G) A project is described in this subparagraph if—

(i) the project is a newspaper printing and distribution plant project with respect to which a contract for the purchase of 8 printing press units and related equipment to be installed in a single press line was entered into on January 8, 1985, and

(ii) the contract price for such units and equipment represents at least 50 percent of the total cost of such project.

(H) A project is described in this subparagraph if it is the second phase of a project involving direct current transmission lines spanning approximately 190 miles from the United States-Canadian border to Ayer, Massachusetts, alternating current transmission lines in Massachusetts from Ayers to Millbury to West Medway, DC–AC converted terminals to Monroe, New Hampshire, and Ayer, Massachusetts, and other related equipment and facilities.

(I) A project is described in this subparagraph if it involves not more than two natural gas-fired combined cycle electric generating units each having a net electrical capability of approximately 233 megawatts, and a sales contract for approximately ½ of the output of the 1st unit was entered into in December 1985.

(J) A project is described in this subparagraph if—

(i) the project involves an automobile manufacturing facility (including equipment and incidental appurtenances) to be located in the United States, and

(ii) either—

(I) the project was the subject of a memorandum of understanding between 2 automobile manufacturers that was signed before September 25, 1985, the automobile manufacturing facility (including equipment and incidental appurtenances) will involve a total estimated cost of approximately $750,000,000, and will have an annual production capacity of approximately 240,000 vehicles or

(II) the Board of Directors of an automobile manufacturer approved a written plan for the conversion of an existing facility to produce a new model of a vehicle currently not produced in the United States, such facility will be placed in service by July 1, 1987, and such Board action occurred in July 1985, with respect to a $523 million expenditure, in June 1983, with respect to a $475 million expenditure, or in July 1984, with respect to a $312 million expenditure.

(K) A project is described in this subparagraph if either—

(i) the project involves a joint venture between a utility company and a paper company for a super calendar paper mill, and at least $50,000,000 were incurred or committed with respect to such project before March 1, 1986, or

(ii) the project involves a paper mill for the manufacture of newsprint (including a cogeneration facility) is generally based on a written design and feasibility study that was completed on December 15, 1981, and will be placed in service before January 1, 1991, or

(iii) the project is undertaken by a Maine corporation and involves the modernization of pulp and paper

mills in Millinocket and/or East Millinocket, Maine, or

(iv) the project involves the installation of a paper machine for production of coated publication papers, the modernization of a pulp mill, and the installation of machinery and equipment with respect to related processes, as of December 31, 1985, in excess of $50 million was incurred for the project, as of July 1986, in excess of $150 million was incurred for the project, and the project is located in Pine Bluff, Arkansas, or

(v) involves property of a type described in ADR classes 26.1, 26.2, 25, 00.3 and 00.4 included in a paper plant which will manufacture and distribute tissue, towel or napkin products; is located in Effingham County, Georgia; and is generally based upon a written General Description which was submitted to the Georgia Department of Revenue on or about June 13, 1985.

(L) A project is described in this subparagraph if—

(i) a letter of intent with respect to such project was executed on June 4, 1985, and

(ii) a 5-percent downpayment was made in connection with such project for 2 10-unit press lines and related equipment.

(M) A project is described in this subparagraph if—

(i) the project involves the retrofit of ammonia plants,

(ii) as of March 1, 1986, more than $390,000 had been expended for engineering and equipment, and

(iii) more than $170,000 was expensed in 1985 as a portion of preliminary engineering expense.

(N) A project is described in this subparagraph if the project involves bulkhead intermodal flat cars which are placed in service before January 1, 1987, and either—

(i) more than $2,290,000 of expenditures were made before March 1, 1986, with respect to a project involving up to 300 platforms, or

(ii) more than $95,000 of expenditures were made before March 1, 1986, with respect to a project involving up to 850 platforms.

(O) A project is described in this subparagraph if—

(i) the project involves the production and transportation of oil and gas from a well located north of the Arctic Circle, and

(ii) more than $200,000,000 of cost had been incurred or committed before September 26, 1985.

(P) A project is described in this subparagraph if—

(i) a commitment letter was entered into with a financial institution on January 23, 1986, for the financing of the project,

(ii) the project involves intercity communication links (including microwave and fiber optics communications systems and related property),

(iii) the project consists of communications links between—

(I) Omaha, Nebraska, and Council Bluffs, Iowa,

(II) Waterloo, Iowa and Sioux City, Iowa,

(III) Davenport, Iowa and Springfield, Illinois, and

(iv) the estimated cost of such project is approximately $13,000,000.

(Q) A project is described in this subparagraph if—

(i) such project is a mining modernization project involving mining, transport, and milling operations,

(ii) before September 26, 1985, at least $20,000,000 was expended for engineering studies which were approved by the Board of Directors of the taxpayer on January 27, 1983, and

(iii) such project will involve a total estimated minimum cost of $350,000,000.

(R) A project is described in this subparagraph if—

(i) such project is a dragline acquired in connection with a 3-stage program which began in 1980 to increase production from a coal mine,

(ii) at least $35,000,000 was spent before September 26, 1985, on the 1st 2 stages of the program, and

(iii) at least $4,000,000 was spent to prepare the mine site for the dragline.

(S) A project is described in this subparagraph if it is a project consisting of a mineral processing facility using a heap leaching system (including waste dumps, low-grade dumps, a leaching area, and mine roads) and if—

(i) convertible subordinated debentures were issued in August 1985, to finance the project,

(ii) construction of the project was authorized by the Board of Directors of the taxpayer on or before December 31, 1985,

(iii) at least $750,000 was paid or incurred with respect to the project on or before December 31, 1985, and

(iv) the project is placed in service on or before December 31, 1986.

(T) A project is described in this subparagraph if it is a plant facility on Alaska's North Slope and—

(i) the approximate cost is $575 million, of which approximately $100 million was spent on off-site construction or

(ii) the approximate cost of which is $450 million, of which approximately $100 was spent on off-site construction, more than 50 percent of the project cost was spent prior to December 31, 1985, and which will be placed in service in 1987.

(U) A project is described in this subparagraph if it involves the connecting of existing retail stores in the downtown area of a city to a new covered area, the total project will be 250,000 square feet, a formal Memorandum of Understanding relating to development of the project was executed with the city on July 2, 1986, and the estimated cost of the project is $18,186,424.

(V) A project is described in this subparagraph if it includes a 200,000 square foot office tower, a 200-room hotel, a 300,000 square foot retail center, an 800-space parking facility, the total cost is projected to be $60 million, and $1,250,000 was expended with respect to the site before August 25, 1986.

(W) A project is described in this subparagraph if it is a joint use and development project including an integrated hotel, convention center, office, related retail facilities and public mass transportation terminal, and vehicle parking facilities which satisfies the following conditions:

(i) is developed within certain air space rights and upon real property exchanged for such joint use and development project which is owned or acquired by a state department of transportation, a regional mass transit district in a county with a population of at least 5,000,000 and a community redevelopment agency;

(ii) such project affects an existing, approximately forty (40) acre public mass transportation bus-way terminal facility located adjacent to an interstate highway;

(iii) a memorandum of understanding with respect to such joint use and development project is executed by a state department of transportation, such a county regional mass transit district and a community redevelopment agency on or before December 31, 1986, and

(iv) a major portion of such joint use and development project is placed in service by December 31, 1990.

(X) A project is described in this subparagraph if—

(i) it is an $8 million project to provide advanced control technology for adipic acid at a plant, which was authorized by the company's Board of Directors in October 1985, at December 31, 1985, $1.4 million was committed and $.4 million expended with respect to such project, or

(ii) it is an $8.3 million project to achieve compliance with state and federal regulations for particulates emissions, which was authorized by the company's Board of Directors in December 1985, by March 31, 1986, $250,000 was committed and $250,000 was expended with respect to such project, or

(iii) it is a $22 million project for the retrofit of a plant that makes a raw material for aspartame, which was approved in the company's December 1985 capital budget, if approximately $3 million of the $22 million was spent before August 1, 1986.

(Y) A project is described in this subparagraph if such project passes through at least 9 states and involves an intercity communication link (including multiple repeater sites and junction stations for microwave transmissions and amplifiers for fiber optics); the link from Buffalo to New York/Elizabeth was completed in 1984; the link from Buffalo to Chicago was completed in 1985; and the link from New York to Washington is completed in 1986.

(6) NATURAL GAS PIPELINE.—The amendments made by section 201 shall not apply to any interstate natural gas pipeline (and related equipment) if—

(A) 3 applications for the construction of such pipeline were filed with the Federal Energy Regulatory Commission before November 22, 1985 (and 2 of which were filed before September 26, 1985), and

(B) such pipeline has 1 of its terminal points near Bakersfield, California.

(7) CERTAIN LEASEHOLD IMPROVEMENTS.—The amendments made by section 201 shall not apply to any reasonable leasehold improvements, equipment and furnishings placed in service by a lessee or its affiliates if—

(A) the lessee or an affiliate is the original lessee of each building in which such property is to be used, and—

(B) such lessee is obligated to lease the building under an agreement to lease entered into before September 26, 1985, and such property is provided for such building, and

(C) such buildings are to serve as world headquarters of the lessee and its affiliates.

For purposes of this paragraph, a corporation is an affiliate of another corporation if both corporations are members of a controlled group of corporations within the meaning of section 1563(a) of the Internal Revenue Code of 1954 without regard to section 1563(b)(2) of such Code. Such lessee shall include a securities firm that meets the requirements of subparagraph (A), except the lessee is obligated to lease the building under a lessee entered into on June 18, 1986.

(8) SOLID WASTE DISPOSAL FACILITIES.—The amendments made by section 201, and section 203(c), shall not apply to the taxpayer who originally places in service any qualified solid waste disposal facility (as defined in section 7701(e)(3)(B) of the Internal Revenue Code of 1986) if before March 2, 1986—

(A) there is a binding written contract between a service recipient and a service provider with respect to the operation of such facility to pay for the services to be provided by such facility, or

(B) a service recipient or governmental unit (or any entity related to such recipient or unit) made a financial commitment of at least $200,000 for the financing or construction of such facility, or

(C) such facility is the Tri-Cities Solid Waste Recovery Project involving Fremont, Newark, and Union City, California, and has received an authority to construct from the Environmental Protection Agency or from a State or local agency authorized by the Environmental Protection Agency to issue air quality permits under the Clean Air Act.

(9) CERTAIN SUBMERSIBLE DRILLING UNITS.—In the case of a binding contract entered into on October October 30, 1984, for the purchase of 6 semi-submersible drilling units at a cost of $425,000,000, such units shall be treated as having an applicable date under subsection 203(b)(2) of January 1, 1991.

(10) WASTEWATER OR SEWAGE TREATMENT FACILITY.—The amendments made by section 201 shall not apply to any proper-

ty which is part of a wastewater or sewage treatment facility if either—

(A) site preparation for such facility commenced before September 1985, and a parish council approved a service agreement with respect to such facility on December 4, 1985, or

(B) a city-parish advertised in September 1985, for bids for construction of secondary treatment improvements for such facility, in May 1985, the city-parish received statements from 16 firms interested in privatizing the wastewater treatment facilities, and the metropolitan council selected a privatizer at its meeting on November 20, 1985, and adopted a resolution authorizing the Mayor to enter into contractual negotiation with the selected privatizer;

(C) the property is part of a wastewater treatment facility with respect to which a binding service agreement between a privatizer and the Western Carolina Regional Sewer Authority with respect to such facility was signed before January 1, 1986;

(D) such property is part of a wastewater treatment facility (located in Cameron County, Texas, within one mile of the City of Harlingen), an application for a wastewater discharge permit was filed with respect to such facility on December 4, 1985, and a City Commission approved a letter of intent relating to a service agreement with respect to such facility on August 7, 1986; or a wastewater facility (located in Harlingen, Texas) which is a subject of the letter of intent and service agreement described in subparagraph (A)(2) of this paragraph and the design of which was contracted for in a letter of intent dated January 23, 1986."

(11) CERTAIN AIRCRAFT.—The amendments made by section 201 shall not apply to any new aircraft with 19 or fewer passenger seats if—

(A) The aircraft is manufactured in Kansas, Florida, Georgia, or Texas. For purposes of this subparagraph, an aircraft is "manufactured" at the point of its final assembly;

(B) The aircraft was in inventory or in the planned production schedule of the final assembly manufacturer, with orders placed for the engine(s) on or before August 16, 1986, the date of conference committee action) and

(C) The aircraft is purchased or subject to a binding contract on or before December 31, 1986, and is delivered and placed in service by the purchase, before July 1, 1987.

Section 211(d)(2)(B) shall not apply to aircraft which meet the requirements of this subparagraph.

(12) CERTAIN SATELLITES.—The amendments made by section 201 shall not apply to any satellite with respect to which—

(A) on or before January 28, 1986, there was a binding contract to construct or acquire a satellite, and

(i) an agreement to launch was in existence on that date, or

(ii) on or before August 5, 1983, the Federal Communications Commission had authorized the construction and for which the authorized party has a specific although undesignated agreement to launch in existence on January 28, 1986;

(B) by order adopted on July 25, 1985, the Federal Communications Commission granted the taxpayer an orbital slot and authorized the taxpayer to launch and operate 2 satellites with a cost of approximately $300,000,000; or

(C) the International Telecommunications Satellite Organization or the International Maritime Satellite Organization entered into written binding contracts before May 1, 1985.

(13) CERTAIN NONWIRE LINE CELLULAR TELEPHONE SYSTEMS.—The amendments made by section 201 shall not apply to property that is part of a nonwire line system in the Domestic Public Cellular Radio Telecommunications Service for which the Federal Communications Commission has issued a construction permit before September 26, 1985, but only if such property is placed in service before January 1, 1987.

(14) CERTAIN COGENERATION FACILITIES.—The amendments made by section 201 shall not apply to projects consisting of 1 or more facilities for the cogeneration and distribution of electricity and steam or other forms of thermal energy if—

(A) at least $100,000 was paid or incurred with respect to the project before March 1, 1986, a memorandum of understanding was executed on September 13, 1985, and the project is placed in service before January 1, 1989,

(B) at least $500,000 was paid or incurred with respect to the projects before May 6, 1986, the projects involve a 22-megawatt combined cycle gas turbine plant and a 45-megawatt coal waste plant, and applications for qualifying facility status were filed with the Federal Energy Regulatory Commission on March 5, 1986,

(C) the project cost approximates $125,000,000 to $140,000,000 and an application was made to the Federal Energy Regulatory Commission in July 1985, or

(D) an inducement resolution for such facility was adopted on September 10, 1985, a development authority was given an inducement date of September 10, 1985, for a loan not to exceed $80,000,000 with respect to such facility, and such facility is expected to have a capacity of approximately 30 megawatts of electric power and 70,000 pounds of steam per hour.

(E) at least $1,000,000 was incurred with respect to the project before May 6, 1986, the project involves a 52-megawatt combined cycle gas turbine plant and a petition was filed with the Connecticut Department of Public Utility Control to approve a power sales agreement with respect to the project on March 27, 1986.

(15) CERTAIN ELECTRIC GENERATING STATIONS.—The amendments made by section 201 shall not apply to a project consisting of a coal-fired electric generating station (including multi-

ple generating units, coal mine equipment, and transmission facilities) if—

(A) a tax-exempt entity will own an equity interest in all property included in the project (except the coal mine equipment), and

(B) at least $72,000 was expended in the acquisition of coal leases, land and water rights, engineering studies, and other development costs before May 6, 1986.

For purposes of this subparagraph, subsection (b)(2) shall be applied by substituting "January 1, 1986" for "January 1, 1991."

(16) SPORTS ARENAS.—

(A) INDOOR SPORTS FACILITY.—The amendments made by section 201 shall not apply to up to $20,000,000 of improvements made by a lessee of any indoor sports facility pursuant to a lease from a State commission granting the right to make limited and specified improvements (including planned seat explanations), if architectural renderings of the project were commissioned and received before December 22, 1985.

(B) METROPOLITAN SPORTS ARENA.—The amendments made by section 201 shall not apply to any property which is part of an arena constructed for professional sports activities in a metropolitan area, provided that such arena is capable of seating no less than 18,000 spectators and a binding contract to incur significant expenditures for its construction was entered into before June 1, 1986.

(17) CERTAIN WASTE-TO-ENERGY FACILITIES.—The amendments made by section 201 shall not apply to 2 agricultural waste-to-energy powerplants (and required transmission facilities), in connection with which a contract to sell 100 megawatts of electricity to a city was executed in October 1984.

(18) CERTAIN COAL-FIRED PLANTS.—The amendments made by section 201 shall not apply to one of three 540 megawatt coal-fired plants that are placed in service after a sale leaseback occurring after January 1, 1986, if—

(A) the Board of Directors of an electric power cooperation authorized the investigation of a sale leaseback of a nuclear generation facility by resolution dated January 22, 1985, and

(B) a loan was extended by the Rural Electrification Administration on February 20, 1986, which contained a covenant with respect to used property leasing from unit II.

(19) CERTAIN REAL SYSTEMS.—

(A) The amendments made by section 201 shall not apply to a light rail transit system, the approximate cost of which is $235,000,000, if, with respect to which, the board of directors of a corporation (formed in September 1984 for the purpose of developing, financing, and operating the system) authorized a $300,000 expenditure for a feasibility study in April 1985.

(B) The amendments made by section 201 shall not apply to any project for rehabilitation of regional railroad rights of way and properties including grade crossings which was authorized by the Board of Directors of such company prior

to October 1985; and/or was modified, altered or enlarged as a result of termination of company contracts, but approved by said Board of Directors no later than January 30, 1986, and which is in the public interest, and which is subject to binding contracts or substantive commitments by December 31, 1987.

(20) CERTAIN DETERGENT MANUFACTURING FACILITY.—The amendments made by section 201 shall not apply to a laundry detergent manufacturing facility, the approximate cost of which is $13,200,000, with respect to which a project agreement was fully executed on March 17, 1986.

(21) CERTAIN RESOURCE RECOVERY FACILITY.—The amendments made by section 201 shall not apply to any of 3 resource recovery plants, the aggregatre cost of which approximates $300,000,000, if an industrial development authority adopied a bond resolution with respect to such facilities on December 17, 1984, and the projects were approved by the department of commerce of a Commonwealth on December 27, 1984.

(22) The amendments made by section 201 shall not apply to a computer and office support center building in Minneapolis, with respect to which the first contract, with an architecture frim, was signed on April 30, 1985, and a construction contract was signed on March 12, 1986.

(23) CERTAIN DISTRICT HEATING AND COOLING FACILITIES.—The amendment made by section 201 shall not apply to pipes, mains, and related equipment included in district heating and cooling facilities, with respect to which the development authority of a State approved the project through an inducement resolution adopted on October 8, 1985, and in connection with which approximately $11,000,000 of tax-exempt bonds are to be issued.

(24) CERTAIN VESSELS.—

(A) CERTAIN OFFSHORE VESSELS.—The amendments made by section 201 shall not apply to any offshore vessel the construction contract for which was signed on February 28, 1986, and the approximate cost of which is $9,000,000.

(B) CERTAIN INLAND RIVER VESSEL.—The amendments made by section 201 shall not apply to a project involving the reconstruction of an inland river vessel docked on the Mississippi River at St. Louis, Missouri, on July 14, 1986, and with respect to which:

(i) the estimated cost of reconstruction is approximately $39,000,000;

(ii) reconstruction was commenced prior to December 1, 1985;

(iii) at least $17,000,000 was expended before December 31, 1985; and

(C) SPECIAL AUTOMOBILE CARRIER VESSELS.—The amendments made by section 201 shall not apply to two new automobile carrier vessels which will cost approximately $47,000,000 and will be constructed by a U.S.-flag carrier to operate, under the U.S.-flag and with an American crew, to transport foreign automobiles to the United States, in a case where negotiations for such transportation arrange-

ments commenced in April 1985, formal contract bids were submitted prior to the end of 1985, and definitive transportation contracts were awarded in May 1986.

(D) The amendments made by section 201 shall not apply to a 562-foot passenger cruise ship, which was purchased in 1980 for the purpose of returning the vessel to U.S. service, the approximate cost of refurbishment of which is approximately $47 million.

(25) CERTAIN WOOD ENERGY PROJECTS.—The amendments made by section 201 shall not apply to two wood energy products for which applications with the Federal Energy Regulatory Commission were filed before January 1, 1986, which are described as follows:

(A) a 26.5 megawatt plant in Fresno, California, and

(B) a 26.5 megawatt plant in Rocklin, California.

(26) The amendments made by section 201 shall not apply to property which is a geothermal project of less than 20 megawatts that was certified by the Federal Energy Regulatory Commission on July 14, 1986, as a qualifying small power production facility for purposes of the Public Utility Regulatory Policies Act of 1978 pursuant to an application filed with the Federal Energy Regulatory Commission on April 17, 1986."

(27) CERTAIN ECONOMIC DEVELOPMENT PROJECTS—The amendments made by section 201 shall not apply to any of the following projects:

(A) A mixed use development on the East River the total cost of which is approximately $400,000,000, with respect to which a letter of intent was executed on January 24, 1984, and with respect to which approximately $2.5 million had been spent by March 1, 1986.

(B) A 356-room hotel, banquet, and conference facility (including 525,000 square feet of office space) the approximate cost of which is $158,000,000, with respect to which a letter of intent was executed on June 1, 1984 and with respect to which an inducement resolution and bond resolution was adopted on August 20, 1985.

(C) Phase 1 of a 4-phase project involving the construction of laboratory space and ground-floor retail space the estimated cost of which is $32,000,000 and with respect to which a memoradum of understanding was made before August 29, 1983.

(D) A project involving the development of a 490,000 square foot mixed-use building at 152 W. 57th Street and 7th Avenue, New York, New York, the estimated cost of which is $100,000,000, and with respect to which a building permit applicaiton was filed in May 1986.

(E) A mixed-use project containing a 300 unit, 12-story hotel, garage, two multi-rise office buildings, and also included a park, renovated riverboat, and barge with festival marketplace, the capital outlays for which approximate $68 million.

(F) The construction of a three-story office building that will serve as the home office for an insurance group and its affiliated companies, with respect to which a city agreed to

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transfer its ownership of the land for the project in a Redevelopment Agreement executed on September 18, 1985, once certain conditions are met.

(G) A commercial bank formed under the laws of the State of New York which entered into an agreement on September 5, 1985, to construct its headquarters at 60 Wall Street, New York, New York, with respect to such headquarters.

(H) Any property which is part of a commercial and residential project, the first phase of which is currently under construction, to be developed on land which is the subject of an ordinance passed on July 20, 1981, by the city council of the city in which such land is located, designating such land and the improvements to be placed thereon as a residential-business planned development, which development is being financed in part by the proceeds of industrial development bonds in the amount of $62,000 issued on December 4, 1985.

(28) The amendment made by section 201 shall not apply to an $80 million capital project steel seamless tubular casings minimill and melting facility located in Youngstown, Ohio, which was purchased by the taxpayer in April 1985, and—

(A) the purchase and renovation of which was approved by a committee of the Board of Directors on February 22, 1985, and

(B) as of December 31, 1985, more than $20,000,000 was incurred or committed with respect to the renovation.

(29) The amendments made by section 201 shall not apply to any project for residential rental property if—

(A) an inducement resolution with respect to such project was adopted by the State housing development authority on January 18, 1985, and

(B) such project was the subject of law suits filed on June 22, 1984, and November 21, 1985.

(30) The amendments made by section 201 shall not apply to a 30 megawatt electric generating facility fueled by geothermal and wood waste, the approximate cost of which is $55 million, and with respect to which a 30-year power sales contract was executed on March 22, 1985.

(31) The amendments made by section 201 shall not apply to railroad maintenance-of-way equipment, with respect to which a Boston bank entered into a firm binding contract with a major northeastern railroad before March 2, 1986, to finance $10.2 million of such equipment, if all of the equipment was placed in service before August 1, 1986.

(32) The amendment made by section 201 shall not apply to—

(A) a facility constructed on approximately seven acres of land located on Ogle's Poso Creek Oil field, the primary fuel of which will be bituminous coal from Utah or Wyoming, with respect to which an application for an authority to construct was filed on July 30, 1984, an authority to construct was issued on February 28, 1985, and a prevention of significant deterioration permit application was submitted on June 17, 1985,

(B) a facility constructed on approximately seven acres of land located on Teorco's Jasmin oil field, the primary fuel of which will be bituminous coal from Utah or Wyoming, with respect to which an authority to construct was filed on August 30, 1984, an authority to construct was issued on May 4, 1985, and a prevention of significant deterioration permit application was submitted on July 3, 1985,

(C) the Mountain View Apartments, in Hadley, Massachusetts,

(D) a facility expected to have a capacity of not less than 65 megawatts of electricity, the steam from which is to be sold to a pulp and paper mill, with respect to which application was made to the Federal Regulatory Commission for certification as a qualified facility on November 1, 1985, and received such certification on January 24, 1986,

(E) $2.2 million of equipment ordered on January 27, 1986, in connection with a 60,000 square foot plant that was completed in 1983,

(F) to a magnetic resonance imaging machine, with respect to which a binding contract to purchase was entered into in April 1986, in connection with the construction of a magnetic resonance imaging clinic with respect to which a Determination of Need certification was obtained from a State Department of Public Health on October 22, 1985, if such property is placed in service before December 31, 1986,

(G) to a company located in Salina, Kansas, which has been engaged in the construction of highways and city streets since 1946, but only to the extent of $1,410,000 of investment in new section 38 property,

(H) to a $300,000 project undertaken by a small metal finishing company located in Minneapolis, Minnesota, the first parts of which were received and paid for in January 1986, with respect to which the company received Board approval to purchase the largest piece of machinery it has ever ordered in 1985,

(I) A $1.2 million finishing machine that was purchased on April 2, 1986 and placed into service in September 1986 by a company located in Davenport, Iowa,

(J) A 25 megawatt small power production facility, with respect to which Qualifying Facility status no. QF86-593-000 was granted on March 5, 1986,

(K) A $600 million 250 megawatt plant placed in service by the Sierra Pacific Power Company,

(L) 128 units of rental housing the Point Gloria Limited Partnership,

(M) Kenosha Harbor, in Kenosha, Wisconsin,

(N) Lakeland Park Phase II, in Baton Rouge, Louisiana,

(O) the Santa Rosa Hotel, in New Orleans, Louisiana,

(P) the Sheraton Baton Rouge, in Baton Rouge, Louisiana,

(Q) $300,000 of equipment placed in service in 1986, in connection with the renovation of the Best Western Townhouse Convention Center in Cedar Rapids, Iowa,

(R) the segment of a nationwide fiber optics telecommunications network placed in service by SouthernNet, the total estimated cost of which is $37 millicn,

(S) two cogeneration facilities, placed in service by the Reading Anthracite Company, costing approximately $110 million each, with respect to which filings were made with the Federal Energy Regulatory Commission on December 31, 1985, and which are located in Pennsylvania,

(T) a fiber optics network placed in service by Kansas City Southern Industries, the total estimated cost of which is $25 million,

(U) 3 newly constructed fishing vessels, and one vessel that is overhauled, placed in service by Mid Coast Marine, but only to the extent of $6.7 million of investment,

(V) $350,000 of equipment acquired in connection with the reopening of a plant in Bristol, Rhode Island, which plant was purchased by Buttonwoods, Ltd., Associates on February 7, 1986,

(W) $4.046 million of equipment placed in service by Brendle's Inc., acquired in connection with a Distribution Center,

(X) a multi-family mixed-use housing project located in a home rule city, the zoning for which was changed to residential business planned development on November 26, 1985, and with respect to which both the home rule city and the State housing finance agency adopted inducement resolutions on December 20, 1985,

(Y) the Myrtle Beach Convention Center, in South Carolina, to the extent of $25 million of investment, and

(Z) railroad cars placed in service by the Pullman Leasing Company, pursuant to an April 3, 1986 purchase order, costing approximately $10 million

(33) The amendments made by section 201 shall not apply to—

(A) $400,000 of equipment placed in service by Super Key Market, if such equipment is placed in service before January 1, 1987,

(B) the Trolley Square project, the total project cost of which is $24.5 million, and the amount of depreciable real property of which is $14.7 million.

(C) a waste-to-energy project in Derry, New Hampshire, costing approximtely $60 million,

(D) the City of Los Angeles Co-composting project, the estimated cost of which is $62 million, with respect to which, on July 17, 1985, the California Pollution Control Financing Authority issued an initial resolution in the maximum amount of $75 million to finance this project,

(E) the St. Charles, Missouri Mixed-Use Center,

(F) Oxford Place in Tulsa, Oklahoma,

(G) an amount of investment generating $20 million of investment tax credits attributable to property used on the Illinois Diversatch Campus,

(H) $25 million of equipment used in the Melrose Park Engine Plant that is sold and leased back by Navistar,

(I) 80 thousand vending machines, for a cost approximating $3.4 million placed into service by Folz Vending Co.

(J) a 24 megawatt alternative energy facility placed in service by Peat Products, with respect to which certification by the Federal Energy Regulatory Commission on April 3, 1986, and

(K) Burbank Manors, in Illinois.

(b) SPECIAL RULE FOR CERTAIN PROPERTY.The provisions of section 168(f)(8) of the Internal Revenue Code of 1954 (as amended by section 209 of the Tax Equity and Fiscal Responsibility Act of 1982) shall continue to apply to any transaction permitted by reason of section 12(c)(2) of the Tax Reform Act of 1984 or section 209(d)(1)(B) of the Tax Equity and Fiscal Responsibility Act of 1982.

(c) APPLICABLE DATE IN CERTAIN CASES.—

(1) Section 203(b)(2) shall be applied by substituting "January 1, 1992" for January 1, 1991" in the following cases.

(A) in the case of a 2-unit nuclear powered electric generating plant (and equipment and incidental appurtenances), constructed pursuant to contracts entered into by the owner operator of the facility before December 31, 1975, including contracts with the engineer/constructor and the nuclear steam system supplier, such contracts shall be treated as contracts described in section 203(b)(1)(A),

(B) a cogeneration facility with respect to which an application with the Federal Energy Regulatory Commission was filed on August 2, 1985, and approved October 15, 1985, and

(C) in the case of a 1,300 megawatt coal-fired steam powered electric generating plant (and related equipment and incidental appurtenances), which the three owners determined in 1984 to convert from nuclear power to coal power and for which more than $600 million had been incurred or committed for construction before September 25, 1985, except that no investment tax credit will be allowable under section 49(d)(3) added by section 211(a) of this Act for any qualified progress expenditures made after December 31, 1990.

(2) Section 203(b)(2) shall be applied by substituting "April 1, 1992" for the applicable date that would otherwise apply, in the case of the second unit of a twin steam electric generating facility and related equipment which was granted a certificate of public convenience and necessity by a public service commission prior to January 1, 1982, if the first unit of the facility was placed in service prior to January 1, 1985, and before September 26, 1985, more than $100,000,000 had been expended toward the construction of the second unit.

(3) Section 203(b)(2) shall be applied by substituting "January 1, 1990," for the applicable date that would otherwise apply in the case of—

(A) new commercial passenger aircraft used by a domestic airline, if a binding contract with respect to such aircraft was entered into before April 1, 1986, and such aircraft has a present class life of 12 years,

(B) a pumped storage hydroelectric project with respect to which an application was made to the Federal Energy Regulatory commission for a license on February 4, 1974, and license was issued August 1, 1977, the project number of which is 2740,

(C) a facility for the manufacture of an improved particleboard, if—a binding contract to purchase such equipment was executed March 3, 1986, such equipment will be placed in service by January 1, 1988, and such facility is located in or near Moncure, North Carolina, and

(D) a newsprint mill in Pend Oreille county, Washington, costing about $290 million.

(7) The amendments made by section 201 shall not apply to a limited amount of the following property or a limited amount of property set forth in submission before September 16, 1986, by the following taxpayers—

(A) Arena project, Michigan,

(B) Campbell Soup Company, Pennsylvania and California,

(C) Overton, Florida,

(D) Legett and Platt,

(E) East Bank Housing Project,

(F) Standard Telephone Company,

(G) Presidential Air,

(H) Ann Arbor Railroad,

(I) Ada, Michigan Cogeneration,

(J) Anchor Store Project, Michigan,

(K) Biogen Power,

(L) $14 million of television transmitting towers placed in service by Media General, Inc., which were subject to binding contracts as of January 21, 1986, and will be placed in service before January 1, 1988,

(M) Hardage Company,

(N) Mesa Airlines,

(O) Yarn-spinning equipment used at Spring Cotton Mills, and

(P) 328 units of low-income housing at Angelus Plaza.

(d) RAILROAD GRADING AND TUNNEL BORES.—

(1) IN GENERAL.—In the case of expenditures for railroad grading and tunnel bores which were incurred by a common carrier by railroad to replace property destroyed in a disaster occurring on or about April 17, 1983, near Thistle, Utah, such expenditures, to the extent not in excess of $15,000,000, shall be treated as recovery property which is 5-year property under section 168 of the Internal Revenue Code of 1954 (as in effect before the amendments made by this Act) and which is placed in service at the time such expenditures were incurred.

(2) BUSINESS INTERRUPTION PROCEEDS.—Business interruption proceeds received for loss of use, revenues, or profits in connection with the disaster described in paragraph (1) and devoted by the taxpayer described in paragraph (1) to the construction of replacement track and related grading and tunnel bore expenditures shall be treated as constituting an amount received from

the involuntary conversion of property under section 1033(a)(2) of such Code.

(3) Effective date.—This subsection shall apply to taxable years ending after April 17, 1983.

(e) Treatment of Certain Disaster Losses.—

(1) In general.—In the case of a disaster described in paragraph (2), at the election of the taxpayer, the amendments made by section 201 of this Act—

(A) shall not apply to any property placed in service during 1987 or 1988, or

(B) shall apply to any property placed in service during 1985 or 1986,

which is property to replace property lost, damaged, or destroyed in such disaster.

(2) Disaster to which section applies.—This section shall apply to a flood which occurred on November 3 through 7, 1985, and which was declared a natural disaster area by the President of the United States.

Subtitle B—Repeal of Regular Investment Tax Credit

SEC. 211. REPEAL OF REGULAR INVESTMENT TAX CREDIT.

(a) General Rule.—Subpart E of part IV of subchapter A of chapter 1 (relating to investment tax credit) is amended by adding at the end thereof the following new section:

"SEC. 49. TERMINATION OF REGULAR PERCENTAGE.

"(a) General Rule.—For purposes of determining the amount of the investment tax credit determined under section 46, the regular percentage shall not apply to any property placed in service after December 31, 1985.

"(b) Exceptions.—Subject to the provisions of subsections (c) and (d), subsection (a) shall not apply to the following:

"(1) Transition property.—Property which is transition property (within the meaning of subsection (e)).

"(2) Qualified progress expenditure for periods before January 1, 1986.—In the case of any taxpayer who has made an election under section 46(d)(6), the portion of the adjusted basis of any progress expenditure property attributable to qualified progress expenditures for periods before January 1, 1986.

ODS BEFORE JANUARY 1, 1986.

"(3) Qualified timber property.—The portion of the adjusted basis of qualified timber property which is treated as section 38 property under section 48 (a)(1)(F).

"(c) 35-Percent Reduction in Credit for Taxable Years After 1986.—

"(1) Reduction in current year investment credit.—Any portion of the current year business credit under section 38(b) for any taxable year beginning after June 30, 1987, which is attributable to the regular investment credit shall be reduced by 35 percent.

"(2) UNEXPIRED CARRYFORWARDS TO 1ST TAXABLE YEAR BEGINNING AFTER JUNE 30, 1987.—Any portion of the business credit carryforward under section 38(a)(1) attributable to the regular investment credit which has not expired as of the close of the taxable year preceding the 1st taxable year of the taxpayer beginning after June 30, 1987, shall be reduced by 35 percent.

"(3) SPECIAL RULE FOR TAXABLE YEARS BEGINNING BEFORE AND ENDING AFTER JULY 1, 1987.—In the case of any taxable year beginning before and ending after July 1, 1987—

"(A) any portion of the current year business credit under section 38(b) for such taxable year, or

"(B) any portion of the business credit carryforward under section 38(a)(1) to such year,

which is attributable to the regular investment credit shall be reduced by the applicable percentage.

"(4) TREATMENT OF DISALLOWED CREDIT.—

"(A) IN GENERAL.—The amount of the reduction of the regular investment credit under paragraphs (1) and (2) shall not be allowed as a credit for any taxable year.

"(B) NO CARRYBACK FOR YEAR STRADDLING JULY 1, 1987; GROSS UP OF CARRYFORWARDS.—The amount of the reduction of the regular investment credit under paragraph (3)—

"(i) may not be carried back to any taxable year, but

"(ii) shall be added to the carryforwards from the taxable year before applying paragraph (2).

"(5) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) APPLICABLE PERCENTAGE.—The term 'applicable percentage' means, with respect to a taxable year beginning before and ending after July 1, 1987, the percentage which bears the same ratio to 35 percent as—

"(i) the number of months in such taxable year after June 30, 1987, bears to

"(ii) the number of months in such taxable year.

"(B) REGULAR INVESTMENT CREDIT.—

"(i) IN GENERAL.—The term 'regular investment credit' has the meaning given such term by section 48(o).

"(ii) EXCEPTION FOR TIMBER PROPERTY.—The term 'regular investment credit' shall not include any portion of the regular investment credit which is attributable to section 38 property described in section 48(a)(1)(F).

"(C) PORTION OF CREDITS ATTRIBUTABLE TO REGULAR INVESTMENT CREDIT.—The portion of any current year business credit or business credit carryforward which is attributable to the regular investment credit shall be determined on the basis that the regular investment credit is used first.

"(d) FULL BASIS ADJUSTMENT.—

"(1) IN GENERAL.—In the case of periods after December 31, 1985, section 48(q) (relating to basis adjustment to section 38 property) shall be applied with respect to transaction property—

"(A) by substituting '100 percent' for '50 percent' in paragraph (1), and

"(B) without regard to paragraph (4) thereof (relating to election of reduced credit in lieu of basis adjustment).

"(2) SPECIAL RULE FOR QUALIFIED PROGRESS EXPENDITURES.—If the taxpayer made an election under section 48(q)(4) with respect to any qualified progress expenditures for periods before January 1, 1986—

"(A) paragraph (1) shall not apply to the portion of the adjusted basis attributable to such expenditures, and

"(B) such election shall not apply to such expenditures for periods after December 31, 1985.

"(e) TRANSITION PROPERTY.—For purposes of this section—

"(1) TRANSITION PROPERTY.—The term 'transition property' means any property placed in service after December 31, 1985, and to which the amendments made by section 201 of the Tax Reform Act of 1986 do not apply, except that in making such determination—

"(A) section 203(a)(1)(A) of such Act shall be applied by substituting '1985' for '1986',

"(B) sections 203(b)(1) and 204(a)(3) of such Act shall be applied by substituting 'December 31, 1985' for 'March 1, 1986',

"(C) in the case of transition property with a class life of less than 7 years—

"(i) section 203(b)(2) of such Act shall apply, and

"(ii) in the case of property with a class life—

"(I) of less than 5 years, the applicable date shall be July 1, 1986, and

"(II) at least 5 years, but less than 7 years, the applicable date shall be January 1, 1987, and

"(D) section 203(b)(3) shall be applied by substituting '1986' for '1987'.

"(2) TREATMENT OF PROGRESS EXPENDITURES.—No progress expenditures for periods after December 31, 1985, with respect to any property shall be taken into account for purposes of applying the regular percentage unless it is reasonable to expect that such property will be transition property when placed in service. If any progress expenditures are taken into account by reason of the preceding sentence and subsequently there is not a reasonable expectation that such property would be transition property when placed in service, the credits attributable to progress expenditures with respect to such property shall be recaptured under section 47."

(b) NORMALIZATION RULES.—If, for any taxable year beginning after December 31, 1985, the requirements of paragraph (1) or (2) of section 46(f) of the Internal Revenue Code of 1986 are not met with respect to public utility property to which the regular percentage applied for purposes of determining the amount of the investment tax credit—

(1) all credits for open taxable years as of the time of the final determination referred to in section 46(f)(4)(A) of such Code shall be recaptured, and

(2) if the amount of the taxpayer's unamortized credits (or the credits not previously restored to rate base) with respect to such property (whether or not for open years) exceeds the amount re-

ferred to in paragraph (1), the taxpayer's tax for the taxable year shall be increased by the amount of such excess. If any portion of the excess described in paragraph (2) is attributable to a credit which is allowable as a carryover to a taxable year beginning after December 31, 1985, in lieu of applying paragraph (2) with respect to such portion, the amount of such carryover shall be reduced by the amount of such portion. Rules similar to the rules of this subsection shall apply in the case of any property with respect to which the requirements of section 46(f)(9) of such Code are met.

(c) Conforming Amendment.—The table of sections for subpart E of part IV of subchapter A of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 49. Termination of regular percentage."

(d) Exception for Certain Aircraft Used in Alaska.—

(1) The amendments made by subsection (a) shall not apply to property originally placed in service after December 29, 1982, and before August 1, 1985, by a corporation incorporated in Alaska on May 21, 1953, and used by it—

(A) in part, for the transportation of mail for the United States Postal Service in the State of Alaska, and

(B) in part, to provide air service in the State of Alaska on routes which had previously been served by an air carrier that received compensation from the Civil Aeronautics Board for providing service.

(2) In the case of property described in subparagraph (A)—

(A) such property shall be treated as recovery property described in section 208(d)(5) of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA");

(B) "48 months" shall be substituted for "3 months" each place it appears in applying—

(i) section 48(b)(2)(B) of the Code, and

(ii) section 168(f)(8)(D) of the Code (as in effect after the amendments made by the Technical Corrections Act of 1982 but before the amendments made by TEFRA); and

(C) the limitation of section 168(f)(8)(D)(ii)(III) (as then in effect) shall be read by substituting "the lessee's original cost basis.", for "the adjusted basis of the lessee at the time of the lease.".

(3) The aggregate amount of property to which this paragraph shall apply shall not exceed $60,000,000.

(e) Effective Date.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to property placed in service after December 31, 1985, in taxable years ending after such date.

(2) Exceptions for certain films.—For purposes of determining whether any property is transition property within the meaning of section 49(e) of the Internal Revenue Code of 1986—

(A) in the case of any motion picture or television film, construction shall be treated as including production for purposes of section 203(b)(1) of this Act, and written contemporary evidence of an agreement (in accordance with in-

dustry practice) shall be treated as a written binding contract for such purposes,

(B) in the case of any television film, a license agreement or agreement for production services between a television network and a producer shall be treated as a binding contract for purposes of section 203(b)(1)(A) of this Act, and

(C) a motion picture film shall be treated as described in section 203(b)(1)(A) of this Act if—

(i) funds were raised pursuant to a public offering before September 26, 1985, for the production of such film,

(ii) 40 percent of the funds raised pursuant to such public offering are being spent on films the production of which commenced before such date, and

(iii) all of the films funded by such public offering are required to be distributed pursuant to distribution agreements entered into before September 26, 1985.

(3) NORMALIZATION RULES.—The provisions of subsection (b) shall apply to any violation of the normalization requirements under paragraph (1) or (2) of section 46(f) of the Internal Revenue Code of 1986 occurring in taxable years ending after December 31, 1985.

(4) ADDITIONAL EXCEPTIONS.—

(A) Paragraphs (c) and (d) of section 49 of the Internal Revenue Code of 1954 shall not apply to any continuous caster facility for slabs and blooms which is subject to a lease and which is part of a project the second phase of which is a continuous slab caster which was placed in service before December 31, 1935.

(B) For purposes of determining whether an automobile manufacturing facility (including equipment and incidental appurtenances) is transition property within the meaning of section 49(e), property with respect to which the Board of Directors of an automobile manufacturer formally approved the plan for the project on January 7, 1985 shall be treated as transition property, but only with respect to $70 million of regular investment tax credits.

SEC. 212. EFFECTIVE 15-YEAR CARRYBACK OF EXISTING CARRYFORWARDS OF STEEL COMPANIES.

(a) GENERAL RULE.—If a qualified corporation makes an election under this section for its 1st taxable year beginning after December 31, 1986, with respect to any portion of its existing carryforwards, the amount determined under subsection (b) shall be treated as a payment against the tax imposed by chapter 1 of the Internal Revenue Code of 1986 made by such corporation on the last day prescribed by law (without regard to extensions) for filing its return of tax under chapter 1 of such Code for such 1st taxable year.

(b) AMOUNT.—For purposes of subsection (a), the amount determined under this subsection shall be the lesser of—

(1) 50 percent of the portion of the corporation's existing carryforwards to which the election under subsection (a) applies, or

(2) the corporation's net tax liability for the carryback period.

(c) CORPORATION MAKING ELECTION MAY NOT USE SAME AMOUNTS UNDER SECTION 38.—In the case of a qualified corporation which makes an election under subsection (a), the portion of such corporation's existing carryforwards to which such an election applies shall not be taken into account under section 38 of the Internal Revenue Code of 1986 for any taxable year beginning after December 31, 1986.

(d) NET TAX LIABILITY FOR CARRYBACK PERIOD.—For purposes of this section—

(1) IN GENERAL.—A corporation's net tax liability for the carryback period is the aggregate of such corporation's net tax liability for taxable years in the carryback period.

(2) NET TAX LIABILITY.—The term "net tax liability" means, with respect to any taxable year, the amount of the tax imposed by chapter 1 of the Internal Revenue Code of 1954 for such taxable year, reduced by the sum of the credits allowable under part IV of subchapter A of such chapter 1 (other than section 34 thereof). For purposes of the preceding sentence, any tax treated as not imposed by chapter 1 of such Code under section 26(b)(2) of such Code shall not be treated as tax imposed by such chapter 1.

(3) CARRYBACK PERIOD.—The term "carryback period" means the period—

(A) which begins with the corporation's 15th taxable year preceding the 1st taxable year from which there is an unused credit included in such corporation's existing carryforwards (but in no event shall such period begin before the corporation's 1st taxable year ending after December 31, 1961), and

(B) which ends with the corporation's last taxable year beginning before January 1, 1986.

(e) NO RECOMPUTATION OF MINIMUM TAX, ETC.—Nothing in this section shall be construed to affect—

(1) the amount of the tax imposed by section 56 of the Internal Revenue Code of 1986, or

(2) the amount of any credit allowable under such Code,

for any taxable year in the carryback period.

(f) REINVESTMENT REQUIREMENT.—

(1) IN GENERAL.—Any amount determined under this section must be committed to reinvestment in, and modernization of the steel industry through investment in modern plant and equipment, research and development, and other appropriate projects, such as working capital for steel operations and programs for the retraining of steel workers.

(2) GENERAL RULE.—In this section applies to LTV Corporation in lieu of the requirements of paragraph (1),

(A) such corporation shall place such refund in a separate account; and

(B) amounts in such separate account—

(i) shall only be used by the corporation—

(I) to purchase an insurance policy which provides that, in the event the corporation becomes involved in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Internal Revenue Code of

1954), the insurer will provide life and health insurance coverage during the 1-year period beginning on the date such inolvement begins to any individual with respect to whom the corporation would (but for such involvement) have been obligated to provide such coverage the coverage provided by the insurer will be identical to the coverage which the corporation would (but for such involvement) have been obligated to provide, and provides that the payment of insurance premiums will not be required during such 1-year period to keep such policy in force, or

(II) directly in connection with the trade or business of the corporation in the manufacturer or production of steel; and

(ii) shall be used (or obligated) for purposes described in clause (i) not later than 3 months after the corporation receives the refund.

(g) DEFINITIONS.—For purposes of this section—

(1) QUALIFIED CORPORATION.—

(A) IN GENERAL.—The term "qualified corporation" means any corporation which is described in section 806(b) of the Steel Import Stabilization Act and a company which was uncorporated on February 11, 1983, in Michigan.

(B) CERTAIN PREDECESSORS INCLUDED.—In the case of any qualified corporation which has carryforward attributable to a predecessor corporation described in such section 806(b), the qualified corporation and the predecessor corporation shall be treated as 1 corporation for purposes of subsections (d) and (e).

(2) EXISTING CARRYFORWARDS.—The term "existing carryforward" means the aggregate of the amounts which—

(A) are unused business credit carryforwards to the taxpayer's 1st taxable year beginning after December 31, 1986 (determined without regard to the limitations of section 38(c) and any reduction under section 49 of the Internal Revenue Code of 1986), and

(B) are attributable to the amount of the regular investment credit determined under section 46(a)(1) of such Code (relating to regular percentage), or any corresponding provision of prior law, determined on the basis that the regular investment credit was used first.

SEC. 213. EFFECTIVE 15-YEAR CARRYBACK OF EXISTING CARRYFORWARDS OF QUALIFIED FARMERS.

(a) GENERAL RULE.—If a taxpayer who is a qualified farmer makes an election under this section for its 1st taxable year beginning after December 31, 1986, with respect to any portion of its existing carryforwards, the amount determined under subsection (b) shall be treated as a payment against the tax imposed by chapter 1 of the Internal Revenue Code of 1986 made by such taxpayer on the last day prescribed by law (without regard to extensions) for filing its return of tax under chapter 1 of such Code for such 1st taxable year.

(b) Amount.—For purposes of subsection (a), the amount determined under this subsection shall be equal to the smallest of—

(1) 50 percent of the portion of the taxpayer's existing carryforwards to which the election under subsection (a) applies,

(2) the taxpayer's net tax liability for the carryback period (within the meaning of section 212(d) of this Act), or

(3) $750.

(c) Taxpayer Making Election May Not Use Same Amounts Under Section 38.—In the case of a qualified farmer who makes an election under subsection (a), the portion of such farmer's existing carryforwards to which such an election applies shall not be taken into account under section 38 of the Internal Revenue Code of 1986 for any taxable year beginning after December 31, 1986.

(d) No Recomputation of Minimum Tax, Etc.—Nothing in this section shall be construed to affect—

(1) the amount of the tax imposed by section 56 of the Internal Revenue Code of 1954, or

(2) the amount of any credit allowable under such Code,

for any taxable year in the carryback period (within the meaning of section 212(d)(3) of this Act).

(e) Definitions and Special Rules.—For purposes of this section—

(1) Qualified farmer.—The term "qualified farmer" means any taxpayer who, during the 3-taxable year period preceding the taxable year for which an election is made under subsection (a), derived 50 percent or more of the taxpayer's gross income from the trade or business of farming.

(2) Existing carryforward.—The term "existing carryforward" means the aggregate of the amounts which—

(A) are unused business credit carryforwards to the taxpayer's 1st taxable year beginning after December 31, 1986 (determined without regard to the limitations of section 38(c) of the Internal Revenue Code of 1986), and

(B) are attributable to the amount of the investment credit determined under section 46(a) of such Code (or any corresponding provision of prior law) with respect to section 38 property which was used by the taxpayer in the trade or business of farming, determined on the basis that such credit was used first.

(3) Farming.—The term "farming" has the meaning given such term by section 2032A(e) (4) and (5) of such Code.

Subtitle C—General Business Credit Reduction

SEC. 221. REDUCTION IN TAX LIABILITY WHICH MAY BE OFFSET BY BUSINESS CREDIT FROM 85 PERCENT TO 75 PERCENT.

(a) In General.—Subparagraph (B) of section 38(c)(1) (relating to limitation based on amount of tax) is amended by striking out "85 percent" and inserting in lieu thereof "75 percent".

(b) Effective Date.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1985.

Subtitle D—Research and Development Provisions

SEC. 231. AMENDMENTS RELATING TO CREDIT FOR INCREASING RESEARCH ACTIVITIES.

(a) 3-Year Extension of the Research Credit.—

(1) In general.—Section 30 (relating to credit for increasing research activities) is amended by adding at the end thereof the following new subsection:

"(h) Termination.—

"(1) In general.—This section shall not apply to any amount paid or incurred after December 31, 1988.

"(2) Computation of base period expenses.—In the case of any taxable year which begins before January 1, 1989, and ends after December 31, 1988, any amount for any base period with respect to such taxable year shall be the amount which bears the same ratio to such amount for such base period as the number of days in such taxable year before January 1, 1989, bears to the total number of days in such taxable year."

(2) Conforming amendment.—Subsection (d) of section 221 of the Economic Recovery Tax Act of 1981 is amended—

(A) by striking out ", and before January 1, 1986" in paragraph (1), and

(B) by striking out the last sentence of paragraph (2)(A).

(b) Definition of Qualified Research; Certain Research Not Eligible for Credit.—Subsection (d) of section 30 (defining qualified research) is amended to read as follows:

"(d) Qualified Research Defined.—For purposes of this section—

"(1) In general.—The term 'qualified research' means research—

"(A) with respect to which expenditures may be treated as expenses under section 174,

"(B) which is undertaken for the purpose of discovering information—

"(i) which is technological in nature, and

"(ii) the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and

"(C) substantially all of the activities of which constitute elements of a process of experimentation for a purpose described in paragraph (3).

Such term does not include any activity described in paragraph (4).

"(2) Tests to be applied separately to each business component.—For purposes of this subsection—

"(A) In general.—Paragraph (1) shall be applied separately with respect to each business component of the taxpayer.

"(B) Business component defined.—The term 'business component' means any product, process, computer software, technique, formula, or invention which is to be—

"(i) held for sale, lease, or license, or

"(ii) used by the taxpayer in a trade or business of the taxpayer.

"(C) SPECIAL RULE FOR PRODUCTION PROCESSES.—Any plant process, machinery, or technique for commercial production of a business component shall be treated as a separate business component (and not as part of the business component being produced).

"(3) PURPOSES FOR WHICH RESEARCH MAY QUALIFY FOR CREDIT.—For purposes of paragraph (1)(C)—

"(A) IN GENERAL.—Research shall be treated as conducted for a purpose described in this paragraph if it relates to—

"(i) a new or improved function,

"(ii) performance, or

"(iii) reliability or quality.

"(B) CERTAIN PURPOSES NOT QUALIFIED.—Research shall in no event be treated as conducted for a purpose described in this paragraph if it relates to style, taste, cosmetic, or seasonal design factors.

"(4) ACTIVITIES FOR WHICH CREDIT NOT ALLOWED.—The term 'qualified research' shall not include any of the following:

"(A) RESEARCH AFTER COMMERCIAL PRODUCTION.—Any research conducted after the beginning of commercial production of the business component.

"(B) ADAPTATION OF EXISTING BUSINESS COMPONENTS.—Any research related to the adaptation of an existing business component to a particular customer's requirement or need.

"(C) DUPLICATION OF EXISTING BUSINESS COMPONENT.—Any research related to the reproduction of an existing business component (in whole or in part) from a physical examination of the business component itself or from plans, blueprints, detailed specifications, or publicly available information with respect to such business component.

"(D) SURVEYS, STUDIES, ETC.—Any—

"(i) efficiency survey,

"(ii) activity relating to management function or technique,

"(iii) market research, testing, or development (including advertising or promotions),

"(iv) routine data collection, or

"(v) routine or ordinary testing or inspection for quality control.

"(E) COMPUTER SOFTWARE.—Except to the extent provided in regulations, any research with respect to computer software which is developed by (or for the benefit of) the taxpayer primarily for internal use by the taxpayer, other than for use in—

"(i) an activity which constitutes qualified research (determined with regard to this subparagraph), or

"(ii) a production process with respect to which the requirements of paragraph (1) are met.

"(F) FOREIGN RESEARCH.—Any research conducted outside the United States.

"(G) Social sciences, etc.—Any research in the social sciences, arts, or humanities.

"(H) Funded research.—Any research to the extent funded by any grant, contract, or otherwise by another person (or governmental entity)."

(c) Reduction in Credit; Credit for Basic Research Payments to Qualified Organizations.—

(1) In general.—Subsection (a) of section 30 is amended to read as follows:

"(a) General Rule.—For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of—

"(1) 20 percent of the excess (if any) of—

"(A) the qualified research expenses for the taxable year, over

"(B) the base period research expenses, and

"(2) 20 percent of the basic research payments determined under subsection (e)(1)(A)."

(2) Definitions and special rules relating to payments for basic research.—Subsection (e) of section 30 (relating to credit available with respect to certain basic research by colleges, universities, and certain research organizations) is amended to read as follows:

"(e) Credit Allowable With Respect to Certain Payments to Qualified Organizations for Basic Research.—For purposes of this section—

"(1) In general.—In the case of any taxpayer who makes basic research payments for any taxable year—

"(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of—

"(i) such basic research payments, over

"(ii) the qualified organization base period amount, and

"(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

"(2) Basic research payments defined.—For purposes of this subsection—

"(A) In general.—The term 'basic research payment' means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

"(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

"(ii) such basic research is to be performed by such qualified organization.

"(B) Exception to requirement that research be performed by the organization.—In the case of a qualified organization described in subparagraph (C) or (D) of paragraph (6), clause (ii) of subparagraph (A) shall not apply.

"(3) QUALIFIED ORGANIZATION BASE PERIOD AMOUNT.—For purposes of this subsection, the term 'qualified organization base period amount' means an amount equal to the sum of—

"(A) the minimum basic research amount, plus

"(B) the maintenance-of-effort amount.

"(4) MINIMUM BASIC RESEARCH AMOUNT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'minimum basic research amount' means an amount equal to the greater of—

"(i) 1 percent of the average of the sum of amounts paid or incurred during the base period for—

"(I) any in-house research expenses, and

"(II) any contract research expenses, or

"(ii) the amounts treated as contract research expenses during the base period by reason of this subsection (as in effect during the base period).

"(B) FLOOR AMOUNT.—Except in the case of a taxpayer which was in existence during a taxable year (other than a short taxable year) in the base period, the minimum basic research amount for any base period shall not be less than 50 percent of the basic research payments for the taxable year for which a determination is being made under this subsection.

"(5) MAINTENANCE-OF-EFFORT AMOUNT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'maintenance-of-effort amount' means, with respect to any taxable year, an amount equal to the excess (if any) of—

"(i) an amount equal to—

"(I) the average of the nondesignated university contributions paid by the taxpayer during the base period, multiplied by

"(II) the cost-of-living adjustment for the calendar year in which such taxable year begins, over

"(ii) the amount of nondesignated university contributions paid by the taxpayer during such taxable year.

"(B) NONDESIGNATED UNIVERSITY CONTRIBUTIONS.—For purposes of this paragraph, the term 'nondesignated university contribution' means any amount paid by a taxpayer to any qualified organization described in paragraph (6)(A)—

"(i) for which a deduction was allowable under section 170, and

"(ii) which was not taken into account—

"(I) in computing the amount of the credit under this section (as in effect during the base period) during any taxable year in the base period, or

"(II) as a basic research payment for purposes of this section.

"(C) COST-OF-LIVING ADJUSTMENT DEFINED.—

"(i) IN GENERAL.—The cost-of-living adjustment for any calendar year is the cost-of-living adjustment for such calendar year determined under section 1(f)(3).

"(ii) SPECIAL RULE WHERE BASE PERIOD ENDS IN A CALENDAR YEAR OTHER THAN 1983 OR 1984.—If the base period of any taxpayer does not end in 1983 or 1984, section 1(f)(3)(B) shall, for purposes of this paragraph, be applied by substituting the calendar year in which such base period ends for 1987.

"(6) QUALIFIED ORGANIZATION.—For purposes of this subsection, the term 'qualified organization' means any of the following organizations:

"(A) EDUCATIONAL INSTITUTIONS.—Any educational organization which—

"(i) is an institution of higher education (within the meaning of section 3304(f)), and

"(ii) is described in section 170(b)(1)(A)(ii).

"(B) CERTAIN SCIENTIFIC RESEARCH ORGANIZATIONS.—Any organization not described in subparagraph (A) which—

"(i) is described in section 501(c)(3) and is exempt from tax under section 501(a),

"(ii) is organized and operated primarily to conduct scientific research, and

"(iii) is not a private foundation.

"(C) SCIENTIFIC TAX-EXEMPT ORGANIZATIONS.—Any organization which—

"(i) is described in—

"(I) section 501(c)(3) (other than a private foundation), or

"(II) section 501(c)(6),

"(ii) is exempt from tax under section 501(a),

"(iii) is organized and operated primarily to promote scientific research by qualified organizations described in subparagraph (A) pursuant to written research agreements, and

"(iv) currently expends—

"(I) substantially all of its funds, or

"(II) substantially all of the basic research payments received by it,

for grants to, or contracts for basic research with, an organization described in subparagraph (A).

"(D) CERTAIN GRANT ORGANIZATIONS.—Any organization not described in subparagraph (B) or (C) which—

"(i) is described in section 501(c)(3) and is exempt from tax under section 501(a) (other than a private foundation),

"(ii) is established and maintained by an organization established before July 10, 1981, which meets the requirements of clause (i),

"(iii) is organized and operated exclusively for the purpose of making grants to organizations described in subparagraph (A) pursuant to written research agreements for purposes of basic research, and

"(iv) makes an election, revocable only with the consent of the Secretary, to be treated as a private foundation for purposes of this title (other than section 4940, relating to excise tax based on investment income).

"(7) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) BASIC RESEARCH.—The term 'basic research' means any original investigation for the advancement of scientific knowledge not having a specific commercial objective, except that such term shall not include—

"(i) basic research conducted outside of the United States, and

"(ii) basic research in the social sciences, arts, or humanities.

"(B) BASE PERIOD.—The term 'base period' means the 3-taxable-year period ending with the taxable year immediately preceding the 1st taxable year of the taxpayer beginning after December 31, 1983.

"(C) EXCLUSION FROM INCREMENTAL CREDIT CALCULATION.—For purposes of determining the amount of credit allowable under subsection (a)(1) for any taxable year, the amount of the basic research payments taken into account under subsection (a)(2)—

"(i) shall not be treated as qualified research expenses under subsection (a)(1)(A), and

"(ii) shall not be included in the computation of base period research expenses under subsection (a)(1)(B).

"(D) TRADE OR BUSINESS QUALIFICATION.—For purposes of applying subsection (b)(1) to this subsection, any basic research payments shall be treated as an amount paid in carrying on a trade or business of the taxpayer in the taxable year in which it is paid (without regard to the provisions of subsection (b)(3)(B)).

"(E) CERTAIN CORPORATIONS NOT ELIGIBLE.—The term 'corporation' shall not include—

"(i) an S corporation,

"(ii) a personal holding company (as defined in section 542), or

"(iii) a service organization (as defined in section 414(m)(3))."

(d) RESEARCH CREDIT TREATED AS OTHER BUSINESS CREDITS.—

(1) IN GENERAL.—Section 38(b) (relating to current year business credit), as amended by this Act, is amended by striking out "plus" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof ", plus", and by adding at the end thereof the following new paragraph:

"(4) the research credit determined under section 41(a)."

(2) TRANSFER OF RESEARCH CREDIT TO SUBPART RELATING TO BUSINESS CREDITS.—Section 30 (relating to credit for increasing research activities) is hereby transferred to subpart D of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986 (as amended by this Act), inserted after section 40 of such Code, and redesignated as section 41 of such Code.

(3) TECHNICAL AND CONFORMING AMENDMENTS.—

(A)(i) Subsections (b) and (c) of section 28 are each amended by striking out "section 30" each place it appears and inserting in lieu thereof "section 41".

(ii) Paragraph (2) of section 28(c) is amended by striking out "section 30(b)" and inserting in lieu thereof "section 41(b)".

(iii) Paragraph (4) of section 28(d) is amended by striking out "section 30(f)" and inserting in lieu thereof "section 41(f)".

(iv) Subparagraph (D) of section 28(b)(1) is amended by striking out "1985" and inserting in lieu thereof "1988".

(B) Subsection (d) of section 38, as amended by this Act, is amended by inserting "41(a)," after "40(a),".

(C)(i) Subsection (d) of section 39 (relating to carryback and carry forward of unused credits) is amended by adding at the end thereof the following new paragraph:

"(3) SIMILAR RULES FOR RESEARCH CREDIT.—Rules similar to the rules of paragraphs (1) and (2) shall apply to the credit allowable under section 30 (as in effect before the date of the enactment of the Tax Reform Act of 1986) except that—

"(A) 'December 31, 1985' shall be substituted for 'December 31, 1983' each place it appears, and

"(B) 'January 1, 1986' shall be substituted for 'January 1, 1984'."

(ii) Subsection (g) of section 41 (relating to limitation based on amount of tax), as redesignated by this section, is amended to read as follows:

"(g) SPECIAL RULE FOR PASS-THRU OF CREDIT.—In the case of an individual who—

"(1) owns an interest in an unincorporated trade or business,

"(2) is a partner in a partnership,

"(3) is a beneficiary of an estate or trust, or

"(4) is a shareholder in an S corporation,

the amount determined under subsection (a) for any taxable year shall not exceed an amount (separately computed with respect to such person's interest in such trade or business or entity) equal to the amount of tax attributable to that portion of a person's taxable income which is allocable or apportionable to the person's interest in such trade or business or entity."

(D) Subparagraph (B) of section 108(b)(2) (relating to reduction of tax attributes in title 11 case or insolvency), as amended by this Act, is amended to read as follows:

"(B) GENERAL BUSINESS CREDIT.—Any carryover to or from the taxable year of a discharge of an amount for purposes for determining the amount allowable as a credit under section 38 (relating to general business credit)."

(E) Paragraph (3) of section 280C(b) is amended—

(i) by striking out "section 30(f)(5)" and inserting in lieu thereof "section 41(f)(5)",

(ii) by striking out "section 30(f)(1)(B)" and inserting in lieu thereof "section 41(f)(1)(B)", and

(iii) by striking out "section 30(f)(1)" and inserting in lieu thereof "section 41(f)(1)".

(F) Subsection (c) of section 381 is amended by striking out paragraph (25) and by redesignating paragraph (26) as paragraph (25).

(G) Section 936(h)(5)(C)(i)(I)(a) (defining product area research) is amended by striking out "section 30(b)" and inserting in lieu thereof "section 41(b)".

(H) Section 6411 (relating to tentative carryback and refund adjustments) is amended—

(i) by striking out "by a research credit carryback provided in section 30(g)(2)" in subsection (a),

(ii) by striking out "a research credit carryback or" in subsection (a),

(iii) by striking out "(or, with respect to any portion of a business credit carryback attributable to a research credit carryback from a subsequent taxable year within a period of 12 months from the end of such subsequent taxable year)" in subsection (a), and

(iv) by striking out "unused research credit," each place it appears in subsections (a) and (b).

(I) Subparagraph (C) of section 6511(d)(6) (defining credit carryback) is amended by striking out "and any research credit carryback under section 30(g)(2)".

(J) The table of sections for subpart B of part IV of subchapter A of chapter 1 is amended by striking out the item relating to section 30.

(K) The table of sections for subpart D of such part is amended by inserting after the item relating to section 40 the following new item:

"Sec. 41. Credit for increasing research activities."

(e) Denial of Credit With Respect to Amounts for Certain Leased Personal Property.—Clause (iii) of section 41(b)(2)(A) (defining in-house research expenses), as redesignated by subsection (d), is amended to read as follows:

> *"(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research."*

(f) Deduction for Certain Contributions of Scientific Research Property.—Clause (i) of section 170(e)(4)(B) (relating to special rule for contributions of scientific property used for research) is amended to read as follows:

> *"(i) the contribution is to an organization described in subparagraph (A) or subparagraph (B) of section 41(e)(6),".*

(g) Effective Date.—

(1) In general.—Except as provided in this subsection (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1985.

(2) Subsection (a).—The amendments made by subsection (a) shall apply to taxable years ending after December 31, 1985.

(3) Basic research.—Section 41(a)(2) of the Internal Revenue Code of 1986 (as added by this section), and the amendments made by subsection (c)(2), shall apply to taxable years beginning after December 31, 1986.

SEC. 232. EXTENSION OF CREDIT FOR CLINICAL TESTING EXPENSES FOR CERTAIN DRUGS.

Subsection (e) of section 28 (relating to termination) is amended by striking out "1987" and inserting in lieu thereof "1990".

Subtitle E—Changes in Certain Amortization Provisions

SEC. 241. REPEAL OF 5-YEAR AMORTIZATION OF TRADEMARK AND TRADE NAME EXPENDITURES.

(a) In General.—Section 177 (relating to trademark and trade name expenditures) is hereby repealed.

(b) Technical and Conforming Amendments.—

(1) Paragraph (3) of section 312(n) is amended by striking out ", 177,".

(2) Subsection (a) of section 1016 (relating to adjustments to basis) is amended by striking out paragraph (16) and by redesignating paragraphs (17) through (27) as paragraphs (16) through (26), respectively.

(3) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 177.

(c) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to expenditures paid or incurred after December 31, 1986.

(2) Transitional rule.—The amendments made by this section shall not apply to any expenditure incurred—

(A) pursuant to a binding contract entered into before March 2, 1986, or

(B) with respect to the development, protection, expansion, registration or defense of a trademark or trade name commenced before March 2, 1986, but only if not less than the lesser of $1,000,000 or 5 percent of the aggregate cost of such development, protection, expansion, registration, or defense has been incurred or committed before such date.

The preceding sentence shall not apply to any expenditure with respect to a trademark or trade name placed in service after December 31, 1987.

SEC. 242. REPEAL OF AMORTIZATION OF RAILROAD GRADING AND TUNNEL BORES.

(a) In General.—Section 185 (relating to amortization of railroad grading and tunnel bores) is hereby repealed.

(b) Technical and Conforming Amendments.—

(1) Subparagraph (B) of section 1082(a)(2) is amended by striking out ", 185,".

(2) Paragraph (3) of section 1250(b) (defining additional depreciation) is amended by inserting "(as in effect before its repeal by the Tax Reform Act of 1986)" after "185".

(3) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 185.

(c) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to that portion of the basis of any property which is attributable to expenditures paid or incurred after December 31, 1986.

(2) Transitional rule.—The amendments made by this section shall not apply to any expenditure incurred—

(A) pursuant to a binding contract entered into before March 2, 1986, or

(B) with respect to any improvement commenced before March 2, 1986, but only if not less than the lesser of $1,000,000 or 5 percent of the aggregate cost of such improvement has been incurred or committed before such date.

The preceding sentence shall not apply to any expenditure with respect to an improvement placed in service after December 31, 1987.

SEC. 243. DEDUCTION FOR BUS AND FREIGHT FORWARDER OPERATING AUTHORITY.

(a) BUS OPERATING AUTHORITY.—

(1) IN GENERAL.—Subject to the modifications contained in paragraph (2), section 266 of the Economic Recovery Tax Act of 1981 shall be applied as if the term "motor carrier operating authority" included a bus operating authority.

(2) MODIFICATIONS.—For purposes of paragraph (1), section 266 of such Act shall be applied—

(A) by substituting "November 19, 1982" for "July 1, 1980" each place it appears, and

(B) by substituting "November 1982" for "July 1980" in subsection (a) thereof.

(3) BUS OPERATING AUTHORITY DEFINED.—For purposes of this subsection and section 266 of such Act, the term "bus operating authority" means—

(A) a certificate or permit held by a motor common or contract carrier of passengers which was issued pursuant to subchapter II of chapter 109 of title 49, United States Code, and

(B) a certificate or permit held by a motor carrier authorizing the transportation of passengers, as a common carrier, over regular routes in intrastate commerce which was issued by the appropriate State agency.

(b) FREIGHT FORWARDER OPERATING AUTHORITY.—

(1) IN GENERAL.—Subject to the modifications contained in paragraph (2), section 266 of the Economic Recovery Tax Act of 1981 shall be applied as if subsection (b) thereof contained "or a freight forwarder" after "contract carrier of property".

(2) MODIFICATIONS.—The modifications referred to in this paragraph are:

(A) 60-MONTH PERIOD TO BEGIN IN 1987.—The 60-month period referred to in section 266(a) of such Act shall begin with the later of—

(i) the deregulation month, or

(ii) at the election of the taxpayer, the 1st month of the taxpayer's 1st taxable year beginning after the deregulation month.

(B) AUTHORITY MUST BE HELD AS OF BEGINNING OF 60-MONTH PERIOD.—A motor carrier operating authority shall not be taken into account unless such authority is held by the taxpayer at the beginning of the 60-month period applicable to the taxpayer under subparagraph (A).

(C) ADJUSTED BASIS NOT TO EXCEED ADJUSTED BASIS AT BEGINNING OF 60-MONTH PERIOD.—The adjusted basis taken into account with respect to any motor carrier operating authority shall not exceed the adjusted basis of such authority as of the beginning of the 60-month period applicable to the taxpayer under subparagraph (A).

(3) DEREGULATION MONTH.—For purposes of this section, the term "deregulation month" means the month in which the Secretary of the Treasury or his delegate determines that a Federal law has been enacted which deregulates the freight forwarding industry.

(c) SPECIAL RULE FOR MOTOR CARRIER OPERATING AUTHORITY.—In the case of a corporation which was incorporated on December 29, 1969, in the State of Delaware, notwithstanding any other provision of law, there shall be allowed as a deduction for the taxable year of the taxpayer beginning in 1980 an amount equal to $2,705,188 for its entire loss due to a decline in value of its motor carrier operating authority by reason of deregulation.

(d) EFFECTIVE DATES.—

(1) BUS OPERATING AUTHORITY.—

(A) IN GENERAL.—Subsection (a) shall apply to taxable years ending after November 18, 1982.

(B) STATUTE OF LIMITATIONS.—If refund or credit of any overpayment of tax resulting from subsection (a) is prevented at any time on or before the date which is 1 year after the date of the enactment of this Act by the operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable to the application of such subsection) may, notwithstanding such law or rule of law, be made or allowed if claim therefore is filed on or before the date which is 18 months after such date of enactment.

(2) FREIGHT FORWARDER OPERATING AUTHORITY.—Subsection (b) shall apply to taxable years ending after the month preceding the deregulation month.

SEC. 244. TREATMENT OF EXPENDITURES FOR REMOVAL OF ARCHITECTURAL BARRIERS TO THE HANDICAPPED AND ELDERLY MADE PERMANENT.

Paragraph (2) of section 190(d) (relating to expenditures to remove architectural and transportation barriers to the handicapped and elderly) is amended by striking out "1983, and before January 1, 1986" and inserting in lieu thereof "1983".

Subtitle F—Provisions Relating to Real Estate

SEC. 251. MODIFICATION OF INVESTMENT TAX CREDIT FOR REHABILITATION EXPENDITURES.

(a) REDUCTION IN PERCENTAGE.—Paragraph (4) of section 46(b) (relating to rehabilitation percentage) is amended to read as follows:

"(4) REHABILITATION PERCENTAGE.—

"(A) IN GENERAL.—The term 'rehabilitation percentage' means—

"(i) 10 percent in the case of qualified rehabilitation expenditures with respect to a qualified rehabilitated building other than a certified historic structure, and

"(ii) 20 percent in the case of such expenditure with respect to a certified historic structure.

"(B) REGULAR AND ENERGY PERCENTAGES NOT TO APPLY.—The regular percentage and the energy percentages shall not apply to that portion of the basis of any property which is attributable to qualified rehabilitation expenditures."

(b) SPECIAL RULES FOR QUALIFIED REHABILITATED BUILDINGS.—Subsection (g) of section 48 (relating to special rules for qualified rehabilitated buildings) is amended to read as follows:

"(g) SPECIAL RULES FOR QUALIFIED REHABILITATED BUILDINGS.—For purposes of this subpart—

"(1) QUALIFIED REHABILITATED BUILDING.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified rehabilitated building' means any building (and its structural components) if—

"(i) such building has been substantially rehabilitated,

"(ii) such building was placed in service before the beginning of the rehabilitation, and

"(iii) in the case of any building other than a certified historic structure, in the rehabilitation process—

"(I) 50 percent or more of the existing external walls of such building are retained in place as external walls,

"(II) 75 percent or more of the existing external walls of such building are retained in place as internal or external walls, and

"(III) 75 percent or more of the existing internal structural framework of such building is retained in place.

"(B) BUILDING MUST BE FIRST PLACED IN SERVICE BEFORE 1936.—In the case of a building other than a certified historic structure, a building shall not be a qualified rehabilitated building unless the building was first placed in service before 1936.

"(C) SUBSTANTIALLY REHABILITATED DEFINED.—

"(i) IN GENERAL.—For purposes of subparagraph (A)(i), a building shall be treated as having been substantially rehabilitated only if the qualified rehabilitation expenditures during the 24-month period selected by the taxpayer (at the time and in the manner prescribed by regulations) and ending with or within the taxable year exceed the greater of—

"(I) the adjusted basis of such building (and its structural components), or

"(II) $5,000.

The adjusted basis of the building (and its structural components) shall be determined as of the beginning of the 1st day of such 24-month period, or of the holding *period of the building, whichever is later. For purposes of the preceding sentence, the determination of the beginning of the holding period shall be made without regard to any reconstruction by the taxpayer in connection with the rehabilitation.*

"(ii) Special rule for phased rehabilitation.—In the case of any rehabilitation which may reasonably be expected to be completed in phases set forth in architectural plans and specifications completed before the rehabilitation begins, clause (i) shall be applied by substituting '60-month period' for '24-month period'.

"(iii) Lessees.—The Secretary shall prescribe by regulation rules for applying this subparagraph to lessees.

"(D) Reconstruction.—Rehabilitation includes reconstruction.

"(2) Qualified rehabilitation expenditure defined.—For purposes of this section—

"(A) In general.—The term 'qualified rehabilitation expenditure' means any amount properly chargeable to capital account—

"(i) for property for which depreciation is allowable under section 168 and which is—

"(I) nonresidential real property,

"(II) residential rental property,

"(III) real property which has a class life of more than 12.5 years, or

"(IV) an addition or improvement to property or housing described in subclause (I), (II), or (III), and

"(ii) in connection with the rehabilitation of a qualified rehabilitated building.

"(B) Certain expenditures not included.—The term 'qualified rehabilitation expenditure' does not include—

"(i) Straight line depreciation must be used.—Any expenditure with respect to which the taxpayer does not use the straight line method over a recovery period determined under subsection (c) or (g) of section 168. The preceding sentence shall not apply to any expenditure to the extent the alternative depreciation system of section 168(g) applies to such expenditure by reason of subparagraph (B) or (C) of section 168(g)(1).

"(ii) Cost of acquisition.—The cost of acquiring any building or interest therein.

"(iii) Enlargements.—Any expenditure attributable to the enlargement of an existing building.

"(iv) Certified historic structure, etc.—Any expenditure attributable to the rehabilitation of a certified historic structure or a building in a registered historic district, unless the rehabilitation is a certified rehabilitation (within the meaning of subparagraph (C)). The preceding sentence shall not apply to a building in a registered historic district if—

"(I) such building was not a certified historic structure,

"(II) the Secretary of the Interior certified to the Secretary that such building is not of historic significance to the district, and

"(III) if the certification referred to in subclause (II) occurs after the beginning of the rehabilitation of such building, the taxpayer certifies to the Secretary that, at the beginning of such rehabilitation, he in good faith was not aware of the requirement of subclause (II).

"(v) TAX-EXEMPT USE PROPERTY.—

"(I) IN GENERAL.—Any expenditure in connection with the rehabilitation of a building which is allocable to that portion of such building which is (or may reasonably be expected to be) tax-exempt use property (within the meaning of section 168(h)).

"(II) CLAUSE NOT TO APPLY FOR PURPOSES OF PARAGRAPH (1)(C).—This clause shall not apply for purposes of determining under paragraph (1)(C) whether a building has been substantially rehabilitated.

"(vi) EXPENDITURES OF LESSEE.—Any expenditure of a lessee of a building if, on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal periods) is less than the recovery period determined under section 168(c).

"(C) CERTIFIED REHABILITATION.—For purposes of subparagraph (B), the term 'certified rehabilitation' means any rehabilitation of a certified historic structure which the Secretary of the Interior has certified to the Secretary as being consistent with the historic character of such property or the district in which such property is located.

"(D) NONRESIDENTIAL REAL PROPERTY; RESIDENTIAL RENTAL PROPERTY; CLASS LIFE.—For purposes of subparagraph (A), the terms 'nonresidential real property', 'residential rental property', and 'class life' have the respective meanings given such terms by section 168.

"(3) CERTIFIED HISTORIC STRUCTURE DEFINED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'certified historic structure' means any building (and its structural components) which—

"(i) is listed in the National Register, or

"(ii) is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

"(B) REGISTERED HISTORIC DISTRICT.—The term 'registered historic district' means—

"(i) any district listed in the National Register, and

"(ii) any district—

"(I) which is designated under a statute of the appropriate State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will *substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and*

"(II) which is certified by the Secretary of the Interior to the Secretary as meeting substantially all of the requirements for the listing of districts in the National Register.

"(4) PROPERTY TREATED AS NEW SECTION 38 PROPERTY.—Property which is treated as section 38 property by reason of subsection (a)(1)(E) shall be treated as new section 38 property."

(c) BASIS ADJUSTMENT FOR CERTIFIED HISTORIC STRUCTURES.—Paragraph (3) of section 48(q) (relating to special rule for qualified rehabilitated buildings) is amended by striking out "other than a certified historic structure".

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to property placed in service after December 31, 1986, in taxable years ending after such date.

(2) GENERAL TRANSITIONAL RULE.—The amendments made by this section and section 201 shall not apply to any property placed in service before January 1, 1994, if such property is placed in service as part of—

(A) a rehabilitation which was completed pursuant to a written contract which was binding on March 1, 1986, or

(B) a rehabilitation incurred in connection with property (including any leasehold interest) acquired before March 2, 1986, or acquired on or after such date pursuant to a written contract that was binding on March 1, 1986, if—

(i) the rehabilitation was completed pursuant to a written contract that was binding on March 1, 1986,

(ii) parts 1 and 2 of the Historic Preservation Certification Application were filed with the Department of the Interior (or its designee) before March 2, 1986, or

(iii) the lesser of $1,000,000 or 5 percent of the cost of the rehabilitation is incurred before March 2, 1986, or is required to be incurred pursuant to a written contract which was binding on March 1, 1986.

(3) CERTAIN ADDITIONAL REHABILITATIONS.—The amendments made by this section and section 201 shall not apply to—

(A) the rehabilitation of 8 bathhouses within the Hot Springs National Park or of buildings in the Central Avenue Historic District at such Park,

(B) the rehabilitation of the Upper Pontabla Building in New Orleans, Louisiana,

(C) the rehabilitation of at least 60 buildings listed on the National Register at the Frankford Arsenal,

(D) the rehabilitation of De Baliveriere Arcade, St. Louis Centre, and Drake Apartments in Missouri,

(E) the rehabilitation of The Tides in Bristol, Rhode Island,

(F) the rehabilitation and renovation of the Outlet Company building and garage in Providence, Rhode Island,

(G) the rehabilitation of 10 structures in Harrisburg, Pennsylvania, with respect to which the Harristown Development Corporation was designated redeveloper and received an option to acquire title to the entire project site for $1 on June 27, 1984,

(H) the rehabilitation of a project involving the renovation of 3 historic structures on the Minneapolis riverfront, with respect to which the developer of the project entered into a redevelopment agreement with a municipality dated January 4, 1985, and industrial development bonds were sold in 3 separate issues in May, July, and October 1985,

(I) the rehabilitation of a bank's main office facilities of approximately 120,000 square feet, in connection with which the bank's board of directors authorized a $3,300,000 expenditure for the renovation and retrofit on March 20, 1984,

(J) the rehabilitation of 10 warehouse buildings built between 1906 and 1910 and purchased under a contract dated February 17, 1986,

(K) the rehabilitation of a facility which is customarily used for conventions and sporting events if an analysis of operations and recommendations of utilization of such facility was prepared by a certified public accounting firm pursuant to an engagement authorized on March 6, 1984, and presented on June 11, 1984, to officials of the city in which such facility is located,

(L) Mount Vernon Mills in Columbia, South Carolina,

(M) the Barbara Jordan II Apartments,

(N) the rehabilitation of the Federal Building and Post Office, 120 Hanover Street, Manchester, New Hampshire,

(O) the rehabilitation of the Charleston Waterfront project in South Carolina,

(P) the Hayes Mansion in San Francisco,

(Q) the renovation of a facility owned by the National Railroad Passenger Corporation ("Amtrak") for which project Amtrak engaged a development team by letter agreement dated August 23, 1985, as modified by letter agreement dated September 9, 1985,

(R) the rehabilitation of a structure or its components which is listed in the National Register of Historic Places, is located in Allegheny County, Pennsylvania, will be substantially rehabilitated (as defined in section 48(g)(1)(C) prior to amendment by this Act), prior to December 31, 1989; and was previously utilized as a market and an auto dealership,

(S) The Bellevue Stratford Hotel in Philadelphia, Pennsylvania,

(T) the Dixon Mill Housing project in Jersey City, New Jersey,

(U) Motor Square Garden,

(V) the Blackstone Apartments, and the Shriver-Johnson building, in Sioux Falls, South Dakota,

(W) the Holy Name Academy in Spokane, Washington,

(X) the Nike/Clemson Mill in Exeter, New Hampshire,

(Y) the Central Bank Building in Grand Rapids, Michigan, and

(Z) the Heritage Hotel, in the City of Marquette, Michigan.

(4) ADDITIONAL REHABILITATIONS.—*The amendments made by this section and section 201 shall not apply to—*

(A) the Fort Worth Town Square Project in Texas,

(B) the American Youth Hostel in New York, New York,

(C) The Riverwest Loft Development (including all three phases, two of which do not involve rehabilitations),

(D) the Gaslamp Quarter Historic District in California,

(E) the Eberhardt & Ober Brewery, in Pennsylvania,

(F) the Captain's Walk Limited Partnership-Harris Place Development, in Connecticut,

(G) the Velvet Mills in Connecticut,

(H) the Roycroft Inn, in New York,

(I) Old Main Village, in Mankato, Minnesota,

(J) the Washburn-Crosby A Mill, in Minneapolis, Minnesota,

(K) the Lakeland marbel Arcade in Lakeland, Florida,

(L) the Willard Hotel, in Washington, D.C.,

(M) the H. P. Lau Building in Lincoln, Nebraska,

(N) the Starks Building, in Louisville, Kentucky,

(O) the Bellevue High School, in Bellevue, Kentucky,

(P) the Major Hampden Smith House, in Owensboro, Kentucky,

(Q) the Doe Run Inn, in Brandenburg, Kentucky,

(R) the State National Bank, in Frankfort, Kentucky,

(S) the Captain Jack House, in Fleming, Kentucky,

(T) the Elizabeth Arlinghaus House, in Louisville, Kentucky,

(U) Limerick Shamrock, in Louisville, Kentucky,

(V) the Robert Mills Project, in South Carolina,

(W) the 620 Project, consisting of 3 buildings, in Kentucky,

(X) the Warrior Hotel, Ltd., the first two floors of the Martin Hotel, and the 105,000 square foot warehouse constructed in 1910, all in Sioux City, Iowa,

(Y) the waterpark condominium residential project, to the extent of $2 million of expenditures, and

(Z) the Apollo and Bishop Building Complex on 125th Street, the Bigelow-Hartford Carpet Mill in New York, New York.

(5) Reduction in credit for property under transitional rules.—In the case of property placed in service after December 31, 1986, and to which the amendments made by this section do not apply, subparagraph (A) of section 46(b)(4) of the Internal Revenue Code of 1954 (as in effect before the enactment of this Act) shall be applied—

(A) by substituting "10 percent" for "15 percent", and

(B) by substituting "13 percent" for "20 percent".

(6) EXPENSING OF REHABILITATION EXPENDITURES FOR THE FRANKFORD ARSENAL.—*In the case of any expenditures paid or incurred in connection with the rehabilitation of the Frankford*

Arsenal during the 8-year period beginning on January 1, 1987, such expenditures (including expenditures for repair and maintenance of the building and property) shall be allowable as a deduction in the taxable year in which paid or incurred in an amount not in excess of the submissions made by the taxpayer before September 16, 1986.

SEC. 252. LOW-INCOME HOUSING CREDIT.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 (relating to business credits) is amended by adding at end thereof the following new section:

"SEC. 42. LOW-INCOME HOUSING CREDIT.

"(a) IN GENERAL.—For purposes of section 38, the amount of the low-income housing credit determined under this section for any taxable year in the credit period shall be an amount equal to—

"(1) the applicable percentage of

"(2) The qualified basis of each qualified low-income building.

"(b) APPLICABLE PERCENTAGE: 70 PERCENT PRESENT VALUE CREDIT FOR CERTAIN NEW BUILDINGS; 30 PERCENT PRESENT VALUE CREDIT FOR CERTAIN OTHER BUILDINGS.—For purposes of this section—

"(1) BUILDING PLACED IN SERVICE DURING 1987.—In the case of any qualified low-income building placed in service by the taxpayer during 1987, the term 'applicable percentage' means—

"(A) 9 percent for new buildings which are not federally subsidized for the taxable year, or

"(B) 4 percent for——

"(i) new buildings which are federally subsidized for the taxable year, and

"(ii) existing buildings.

"(2) BUILDINGS PLACED IN SERVICE AFTER 1987.—

"(A) IN GENERAL.—In the case of any qualified low-income building placed in service by the taxpayer after 1987, the term applicable percentage means the appropriate percentage presecribed by the Secretary for the month in which such building is placed in service.

"(B) METHOD OF PRESCRIBING PERCENTAGES.—The percentages perscribed by the Secretary for any month shall be percentages which will yield over a 10-year period amounts of credit under subsection (a) which have present value equal to—

"(i) 70 percent of the qualified basis of a building described in pargaph (1)(A), and

"(ii) 30 percent of the qualified basis of a building described in paragraph (1)(B).

"(C) METHOD OF DISCOUNTING.—The present value under subparagraph (B) shall be determined—

"(i) as of the last day of the 1st year of the 10-year period referred to in subparagraph (B),

"(ii) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term rate and the annual Federal long-term rate applicable under

section 1274(d)(1) to the month in which the building was placed in service and compounded annually, and

"(iii) by assuming that the credit allowable under this section for any year is received on the last day of such year.

"(3) CROSS REFERENCE.—For treatment of certain rehabilitation expenditures as separate new buildings, see subsection (e).

(c) QUALIFIED BASIS; QUALIFIED LOW-INCOME BUILDING.—For purposes of this section—

"(1) QUALIFIED BASIS.—

"(A) DETERMINATION.—The qualified basis of any qualified low-income building for any taxable year is an amount equal to—

"(i) the applicable fraction (determined as of the close of such taxable year) of

"(ii) the eligible basis of such building (determined under subsection (d)(5)).

"(B) APPLICABLE FRACTION.—For purposes of subparagraph (A), the term 'applicable fraction' means the smaller of the unit fraction or the floor space fraction.

"(C) UNIT FRACTION.—For purposes of subparagraph (B), the term 'unit fraction' means the fraction—

"(i) the numerator of which is the number of low-income units in the building, and

"(ii) the denominator of which is the number of residential rental units (whether or not occupied) in such building.

"(D) FLOOR SPACE FRACTION.—For purposes of subparagraph (B), the term 'floor space fraction' means the fraction—

"(i) the numerator of which is the total floor space of the low-income units in such building, and

"(ii) the denominator of which is the total floor space of the residential rental units (whether or not occupied) in such building.

"(2) QUALIFIED LOW-INCOME BUILDING.—The term 'qualified low-income building' means any building—

"(A) which at all times during the compliance period with respect to such building is part of a qualified low-income housing project, and

"(B) to which the amendments made by section 201(a) of the Tax Reform Act of 1986 apply.

"(d) ELIGIBLE BASIS.—For purposes of this section—

"(1) NEW BUILDINGS.—The eligible basis of a new building is its adjusted basis.

"(2) EXISTING BUILDINGS.—

"(A) IN GENERAL.—The eligible basis of an existing building is—

"(i) in the case of a building which meets the requirements of subparagraph (B), the sum of—

"(I) the portion of its adjusted basis attributable to its acquisition cost, plus

"(II) amounts chargeable to capital account and incurred by the taxpayer (before the close of the 1st

taxable year of the credit period for such building) for property (or additions or improvements to property) of a character subject to the allowance for depreciation, and

"(ii) zero in any other case.

"(B) Requirements.—A building meets the requirements of this subparagraph if—

"(i) the building is acquired by purchase (as defined in section 179(d)(2)),

"(ii) there is a period of at least 10 years between the date of its acquisition by the taxpayer and the later of—

"(I) the date the building was last placed in service , or

"(II) the date of the most recent nonqualified substantial improvement of the building, and

"(iii) the building was not previously placed in service by the taxpayer or by any person who was a related person with respect to the taxpayer as of the time previously placed in service.

"(C) Acquisition cost.—For purposes of subparagraph (A), the cost of any building shall not include so much of the basis of such building as is determined by reference to the basis of other property held at any time by the person acquiring the building.

"(D) Special rules for subparagraph (B).—

"(i) Nonqualified substantial improvement.—For purposes of subparagraph (B)(ii)—

"(I) In general.—The term 'nonqualified substantial improvement' means any substantial improvement if section 167(k) was elected with respect to such improvement or section 168 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) applied to such improvement.

"(II) Date of substantial improvement.—The date of a substantial improvement is the last day of the 24-month period referred to in subclause (III).

"(III) Substantial improvement.—The term 'substantial improvement' means the improvements added to capital account with respect to the building during any 24-month period, but only if the sum of the amounts added to such account during such period equals or exceeds 25 percent of the adjusted basis of the building (determined without regard to paragraphs (2) and (3) of section 1016(a)) as of the 1st day of such period.

"(ii) Special rule for nontaxable exchanges.—For purposes of determining under subparagraph (B)(ii) when a building was last placed in service , there shall not be taken into account any placement in service in connection with the acquisition of the building in a transaction in which the basis of the building in the hands of the person acquiring it is determined in whole or in part by reference

to the adjusted basis of such building in the hands of the person from whom aquired.

"(iii) Related person, etc.—

"(I) Application of section 179.—For purposes of subparagraph (B)(i), section 179(d) shall be applied by substituting "10 percent" for "50 percent" in section 267(b) and 707(b) and in section 179(b)(7).

"(II) Related person.—For purposes of subparagraph (B)(iii), a person (hereinafter in this subclause referred to as the 'related person') is related to any person if the related persons bears a relationship to such person specified in section 267(b) or 707(b)(1), or the related person and such person are engaged in trades or businesses under common control (within the meaning of subsections (a) and (b) of section 52). For purposes of the preceding sentence, in applying section 267(b) or 707(b)(1), '10 percent' shall be substituted for '50 percent'.

"(3) Eligible basis reduced where disproportionate standard for units.—The eligible basis of any building shall be reduced by an amount equal to the portion of the adjusted basis of the building which is attributable to residential rental units in the building which are not low-income units and which are above the average quality standard of the low-income units in the building.

(4) Special rules relating to determination of adjusted basis.—For purposes of this subsection—

"(A) In general.—Except as provided in subparagraph (B), the adjusted basis of any building shall be determined without regard to the adjusted basis of any property which is not residential rental property.

"(B) Basis of property in common areas, etc., included.—The adjusted basis of any building shall be determined by taking into account the adjusted basis of property (of a character subject to the allowance for depreciation) used in common areas or provided as comparable amenities to all residential rental units in such building.

(C) No reduction for depreciation.—The adjusted basis of any building shall be determined without regard to paragraphs (2) and (3) of section 1016(a).

"(5) Eligible basis determined when building placed in service.—

"(A) In general.—Except as provided in subparagraph (B), the eligible basis of any building for the entire compliance period for such building shall be its eligible basis on the date such building is placed in service.

"(B) Eligible basis reduced by federal grants.—If, during any taxable year of the compliance period, a grant is made with respect to any building or the operation thereof and any portion of such grant is funded with Federal funds (whether or not includible in gross income), the eligible basis of such building for such taxable year and all succeeding taxable years shall be reduced by the portion of such grant which is so funded.

"(6) CREDIT ALLOWABLE FOR CERTAIN FEDERALLY-ASSISTED BUILDINGS ACQUIRED DURING 10-YEAR PERIOD DESCRIBED IN PARAPRAPH (2)(B)(II).—

"(A) IN GENERAL.—On application by the taxpayer, the Secretary (after consultation with the appropriate Federal official) may waive paragraph (2)(B)(ii) with respect to any federally-assisted building if the Secretary determines that such waiver is necessary—

"(i) to avert an assignment of the mortgage secured by property in the project (of which such building is a part) to the Department of Housing and Urban Development or the Farmers' Home Administration,

"(ii) to avert a claim against a Federal mortgage insurance fund (or such Department or Administration) with respect to a mortgage which is so secured, or

"(iii) to the extent provided in regulations, by reason of other circumstances of financial distress.

The preceding sentence shall not apply to any building described in paragraph (7)(B).

"(B) FEDERALLY-ASSISTED BUILDING.—For purposes of subparagraph (A), the term 'federally-assisted building' means any building which is substantially assisted, financed, or operated under—

"(i) section 8 of the United States Housing Act of 1937,

"(ii) section 221(d)(3) or 236 of the National Housing Act of 1934, or

"(iii) section 515 of the Housing Act of 1949,

as such Acts are in effect on the date of the enactment of the Tax Reform Act of 1986.

"(C) APPROPRIATE FEDERAL OFFICIAL.—For purposes of subparagraph (A), the term 'appropriate Federal official' means—

"(i) the Secretary of Housing and Urban Development in the case of any building described in subparagraph (B) by reason of clause (i) or (ii) thereof, and

"(ii) the Secretary of Agriculture in the case of any building described in subparagraph (B) by reason of clause (iii) thereof.

"(7) ACQUISITION OF BUILDING BEFORE END OF PRIOR COMPLIANCE PERIOD.—

"(A) IN GENERAL.—Under regulations prescribed by the Secretary, in the case of a building described in subparagraph (B) which is acquired by the taxpayer—

"(i) paragraph (2)(B) shall not apply, but

"(ii) the credit allowable by reason of subsection (a) to the taxpayer for any period after such acquisition shall be equal to the amount of credit which would have been allowable under subsection (a) for such period to the prior owner referred to in subparagraph (B) has such owner not disposed of the building.

"(B) DESCRIPTION OF BUILDING.—A building is described in this subparagraph if—

"(i) a credit was allowed by reason of subsection (a) to any prior owner of such building, and

"(ii) the taxpayer acquired such building before the end of the compliance period for such building with respect to such prior owner (determined without regard to any disposition by such prior owner).

"(e) REHABILITATION EXPENDITURES TREATED AS SEPARATE NEW BUILDING.—

"(1) IN GENERAL.—Rehabilitation expenditures paid or incurred by the taxpayer with respect to any building shall be treated for purposes of this section as a separate new building.

"(2) REHABILITATION EXPENDITURES.—For purposes of paragraph (1)—

"(A) IN GENERAL.—The term 'rehabilitation expenditures' means amounts chargeable to captial account and incurred for property (or additions or improvements to property) of a character subject to the allowance for depreciation in connection with the rehabilitation of a building.

"(B) COST OF ACQUISITION, ETC, NOT INCLUDED.—Such term does not include the cost of acquiring any building (or interest therein) or any amount not permitted to be taken into account under paragraph (3) or (4) of subsection (d).

"(3) AVERAGE OF REHABILITATION EXPENDITURES MUST BE $2,000 OR MORE.—

"(A) IN GENERAL.—Paragraph (1) shall apply to rehabilitation expenditures with respect to any building only if the qualified basis attributable to such expenditures incurred during any 24-month period, when divided by the low-income units in the building, is $2,000 or more.

"(B) DATE OF DETERMINATION.—The determination under subparagraph (A) shall be made as of the close of the 1st taxable year in the credit period with respect to such expenditures.

"(4) SPECIAL RULES.—For purposes of applying this section with respect to expenditures which are treated as a separate building by reason of this subsection—

"(A) such expenditures shall be treated as placed in service at the close of the 24-month period referred to in paragraph (3)(A), and

"(B) the applicable fraction under subsection (c)(1) shall be the applicable fraction for the building (without regard to paragraph (1)) with respect to which the expenditures were incurred.

Nothing in subsection (d)(2) shall prevent a credit from being allowed by reason of this subsection.

"(5) NO DOUBLE COUNTING.—Rehabilitation expenditures may, at the election of the taxpayer, be taken into account under this subsection or subsection (d)(2)(A)(i)(II) but not under both such subsections.

"(6) REGULATIONS TO APPLY SUBSECTION WITH RESPECT TO GROUP OF UNITS IN BUILDING.—The Secretary may prescribe regulations, consistent with the purposes of this subsection, treating a group of units with respect to whch rehabilitation expenditures are incurred as a separate new building.

"(f) DEFINITION AND SPECIAL RULES RELATING TO CREDIT PERIOD.—

"(1) CREDIT PERIOD DEFINED.—For purposes of this section, the term 'credit period' means, with respect to any building, the period of 10 taxable years beginning with the taxable year in which the building is placed in service or, at the election of the taxpayer, the succeeding taxable year. Such an election, once made, shall be irrevocable.

"(2) SPECIAL RULE FOR 1ST YEAR OF CREDIT PERIOD.—

"(A) IN GENERAL.—The credit allowable under subsection (a) with respect to any building for the 1st taxable year of the credit period shall be determined by substituting for the applicable fraction under subsection (c)(1) the fraction—

"(i) the numerator of which is the sum of the applicable fractions determined under subsection (c)(1) as of the close of each full month of such year during which such building was in service, and

"(ii) the denominator of which is 12.

"(B) DISALLOWED 1ST YEAR CREDIT ALLOWED IN 11TH YEAR.—Any reduction by reason of subparagraph (A) in the credit allowable (without regard to subparagraph (A)) for the 1st taxable year of the credit period shall be allowable under subsection (a) for the 1st taxable year following the credit period.

"(3) SPECIAL RULE WHERE INCREASE IN QUALIFIED BASIS AFTER 1ST YEAR OF CREDIT PERIOD.—

"(A) CREDIT INCREASED.—If—

"(i) as of the close of any taxable year in the compliance period (after the 1st year of the credit period) the qualified basis of any building exceeds

"(ii) the qualified basis of such building as of the close of the 1st year of the credit period,

the credit allowable under subsection (a) for the taxable year (determined without regard to this paragraph) shall be increased by an amount equal to the product of such excess and the percentage equal to ⅔ of the applicable percentage for such building.

"(B) 1ST YEAR COMPUTATION APPLIES.—A rule similar to the rule of paragraph (2)(A) shall apply to the additional credit allowable by reason of this paragraph for the 1st year in which such additional credit is allowable.

"(g) QUALIFIED LOW-INCOME HOUSING PROJECT.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified low-income housing project' means any project for residential rental property if the project meets the requirements of subparagraph (A) or (B) whichever is elected by the taxpayer:

"(A) 20–50 TEST.—The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such projet are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income.

"(B) 40–60 TEST.—The project meets the requirements of this subparagraph if 40 percent or more of the residential *units in such project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.*

Any election under this paragraph, once made, shall be irrevocable. For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

"(2) RENT-RESTRICTED UNITS.—

"(A) IN GENERAL.—For purposes of paragraph (1), a residential unit is rent-restricted if the gross rent with respect to such unit does not exceed 30 percent of the income limitation under paragraph (1) applicable to individuals occupying such unit.

"(B) GROSS RENT.—For purposes of subparagraph (A), gross rent—

"(i) does not include any payment under section 8 of the United States Housing Act of 1937 or any comparable Federal rental assistance program (with respect to such unit or occupants thereof), and

"(ii) includes any utility allowance determined by the Secretary after taking into account such determinations under section 8 of the United States Housing Act of 1937.

"(3) DATE FOR MEETING REQUIREMENTS.—

"(A) PROJECTS CONSISTING OF 1 BUILDING.—In the case of a project which does not have any other building in service, such project shall not be treated as meeting the requirements of paragraph (1) unless it meets such requirements not later than the date which is 12 months after the date such project is placed in service.

"(B) PROJECTS CONSISTING OF MORE THAN 1 BUILDING.—In the case of a project which has a building in service when a later building is placed in service as part of such project, such project shall not be treated as meeting the requirements of paragraph (1) with respect to such later building unless—

"(i) such project meets such requirements without regard to such later building on the date such later building is placed in service, and

"(ii) such project meets such requirements with regard to such later building not later than the date which is 12 months after the date such later building is placed in service.

"(4) CERTAIN RULES MADE APPLICABLE.—Paragraphs (2) (other than subparagraph (A) thereof), (3), (4), (5), (6), and (7) of section 142(d), and section 6652(j), shall apply for purposes of determining whether any project is a qualified low-income housing project and whether any unit is a low-income unit.

"(5) ELECTION TO TREAT BUILDING AFTER COMPLIANCE PERIOD AS NOT PART OF A PROJECT.—For purposes of this section, the taxpayer may elect to treat any building as not part of a qualified low-income housing project for any period beginning after the compliance period for such building.

"(h) Limitation on Aggregate Credit Allowable With Respect to Projects Located in a State.—

"(1) Credit may not exceed credit amount allocated to building.—No credit shall be allowed by reason of this section for any taxable year with respect to any building in excess of the housing credit dollar amount allocated to such building under this subsection. An allocation shall be taken into account under the preceding sentence only if it occurs not later than the earlier of—

"(A) the 60th day after the close of the taxable year, or

"(B) the close of the calendar year in which such taxable year ends.

"(2) Allocated credit amount to apply to all taxable years ending during or after credit allocation year.—Any housing credit dollar amount allocated to any building for any calendar year——

"(A) shall apply to such building for all taxable years in the compliance period ending during or after such calendar year, and

"(B) shall reduce the aggregate housing credit dollar amount of the allocating agency only for such calendar year.

"(3) Housing credit dollar amount for agencies.—

"(A) In general.—The aggregate housing credit dollar amount which a housing credit agency may allocate for any calendar year is the portion of the State housing credit ceiling allocated under this paragraph for such calendar year to such agency.

"(B) State ceiling initially allocated to state housing credit agencies.—Except as provided in subparagraphs (D) and (E), the State housing credit ceiling for each calendar year shall be allocated to the housing credit agency of such State. If there is more than 1 housing credit agency of a State, all such agencies shall be treated as a single agency.

"(C) State housing credit ceiling.—The State housing credit ceiling applicable to any State for any calendar year shall be an amount equal to $1.25 multiplied by the State population.

"(D) Special rule for states with constitutional home rule cities.—For purposes of this subsection—

"(i) In general.—The aggregate housing credit dollar amount for any constitutional home rule city for any calendar year shall be an amount which bears the same ratio to the State housing credit ceiling for such calendar year as—

"(I) the population of such city, bears to

"(II) the population of the entire State.

"(ii) Coordination with other allocations.—In the case of any State which contains 1 or more constitutional home rule cities, for purposes of applying this paragraph with respect to housing credit agencies in such State other than constitutional home rule cities, the State housing credit ceiling for any calendar year

shall be reduced by the aggregate housing credit dollar amounts determined for such year for all constitutional home rule cities in such State.

“(iii) CONSTITUTIONAL HOME RULE CITY.—For purposes of this paragraph, the term ‘constitutional home rule city’ has the meaning given such term by section 146(d)(3)(C).

“(E) STATE MAY PROVIDE FOR DIFFERENT ALLOCATION.—Rules similar to the rules of section 146(e) (other than paragraph (2)(B) thereof) shall apply for purposes of this paragraph.

“(F) POPULATION.—For purposes of this paragraph, population shall be determined in accordance with section 146(j).

“(4) CREDIT FOR BUILDINGS FINANCED BY TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP NOT TAKEN INTO ACCOUNT.—

“(A) IN GENERAL.—Paragraph (1) shall not apply to the portion of any credit allowable under subsection (a) which is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under section 103 and which is taken into account under section 146.

“(B) SPECIAL RULE WHERE 70 PERCENT OR MORE OF BUILDING IS FINANCED WITH TAX-EXEMPT BONDS SUBJECT TO VOLUME CAP.—For purposes of subparagraph (A), if 70 percent or more of the aggregate basis of any building and the land on which the building is located is financed by any obligation described in subparagraph (A), paragraph (1) shall not apply to any portion of the credit allowable under subsection (a) with respect to such building.

“(5) PORTION OF STATE CEILING SET-ASIDE FOR CERTAIN PROJECTS INVOLVING QUALIFIED NONPROFIT ORGANIZATIONS.—

“(A) IN GENERAL.—Not more than 90 percent of the State housing credit ceiling for any State for any calendar year shall be allocated to projects other than qualified low-income housing projects described in subparagraphs (B).

“(B) PROJECTS INVOLVING QUALIFIED NONPROFIT ORGANIZATIONS.—For purposes of subparagraph (A), a qualified low-income housing project is described in this subparagraph if a qualified nonprofit organization is to materially participate (within the meaning of section 469(h) in the development and operation of the project throughout the compliance period.

“(C) QUALIFIED NONPROFIT ORGANIZATION.—For purposes of this paragraph, the term ‘qualified nonprofit organization’ means any organization if—

“(i) such organization is described in paragraph (3) or (4) of section 501(c) and is exempt from tax under section 501(a), and

“(ii) 1 of the exempt purposes of such organization includes the fostering of low-income housing.

“(D) STATE MAY NOT OVERRIDE SET-ASIDE.—Nothing in subparagraph (E) of paragraph (3) shall be construed to permit a State not to comply with subparagraph (A) of this paragraph.

"(6) SPECIAL RULES.—

"(A) BUILDING MUST BE LOCATED WITHIN JURISDICTION OF CREDIT AGENCY.—A housing credit agency may allocate its aggregate housing credit dollar amount only to buildings located in the jurisdiction of the governmental unit of which such agency is a part.

"(B) HOUSING CREDIT DOLLAR AMOUNT MAY NOT BE CARRIED OVER, ETC.—

"(i) NO CARRYOVER.—The portion of the aggregate housing credit dollar amount of any housing credit agency which is not allocated for any calendar year may not be carried over to any other calendar year.

"(ii) ALLOCATION MAY NOT BE EARLIER THAN YEAR IN WHICH BUILDING PLACED IN SERVICE.—A housing credit agency may allocate its housing credit dollar amount for any calendar year only to buildings placed in service before the close of such calendar year.

"(C) AGENCY ALLOCATIONS IN EXCESS OF LIMIT.—If the aggregate housing credit dollar amounts allocated by a housing credit agency for any calendar year exceed the portion of the State housing credit ceiling allocated to such agency for such calendar year, the housing credit dollar amounts so allocated shall be reduced (to the extent of such excess) for buildings in the reverse of the order in which the allocations of such amounts were made.

"(D) CREDIT ALLOWABLE DETERMINED WITHOUT REGARD TO AVERAGING CONVENTION, ETC.—For purposes of this subsection, the credit allowable under subsection (a) with respect to any building shall be determined—

"(i) without regard to paragraphs (2)(A) and (3)(B) of subsection (f), and

"(ii) by applying subsection (f)(3)(A) without regard to 'the percentage equal to 2/3 of.'

"(7) OTHER DEFINITIONS.—For purposes of this subsection—

"(A) HOUSING CREDIT AGENCY.—The term 'housing credit agency' means any agency authorized to carry out this subsection.

"(B) POSSESSIONS TREATED AS STATES.—The term 'State' includes a possession of the United States.

"(i) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) COMPLIANCE PERIOD.—The term 'compliance period' means, with respect to any building, the period of 15 taxable years beginning with the 1st taxable year of the credit period with respect thereto.

"(2) DETERMINATION OF WHETHER BUILDING IS FEDERALLY SUBSIDIZED.—

(A) IN GENERAL.—Except as otherwise provided in this paragraph, for purposes of subsection (b)(1), a new building shall be treated as federally subsidized for any taxable year if, at any time during such taxable year, there is outstanding any obligation the interest on which is exempt from tax under section 103, or any below market Federal loan, the

proceeds of which are used (directly or indirectly) with respect to such building or the operation thereof.

"(B) ELECTION TO REDUCE ELIGIBLE BASIS BY OUTSTANDING BALANCE OF LOAN.—A loan shall not be taken into account under subparagraph (A) if the taxpayer elects to exclude an amount equal to the outstanding balance of such loan from the eligible basis of the building for purposes of subsection (d).

"(C) BELOW MARKET FEDERAL LOAN.—For purposes of subparagraph (A), the term 'below market Federal loan' means any loan funded in whole or in part with Federal funds if the interest rate payable on such loan is less than the applicable Federal rate in effect under section 1274(d)(1) (as of the date on which the loan was made).

"(3) LOW-INCOME UNIT.—

"(A) IN GENERAL.—The term 'low-income unit' means any unit in a building if—

"(i) such unit is rent-restricted (as defined in subsection (g)(2)), and

"(ii) the individuals occupying such unit meet the income limitation applicable under subsection (g)(1) to the project of which such building is a part.

"(B) EXCEPTIONS.—A unit shall not be treated as a low-income unit unless the unit is suitable for occupancy and used other than on a transient basis.

"(C) SPECIAL RULE FOR BUILDINGS HAVING 4 OR FEWER UNITS.—In the case of any building which has 4 or fewer residential rental units, no unit in such building shall be treated as a low-income unit if the units in such building are owned by—

"(i) any individual who occupies a residential unit in such building, or

"(ii) any person who is related (as defined in subsection (d)(2)(D)(iii)) to such individual.

"(4) NEW BUILDING.—The term 'new building' means a building the original use of which begins with the taxpayer.

"(5) EXISTING BUILDING.—The term 'existing building' means any building which is not a new building.

"(j) RECAPTURE OF CREDIT.—

"(1) IN GENERAL.—If—

"(A) as of the close of any taxable year in the compliance period, the amount of the qualified basis of any building with respect to the taxpayer is less than

"(B) the amount of such basis as of the close of the preceding taxable year,

then the taxpayer's tax under this chapter for the taxable year shall be increased by the credit recapture amount.

"(2) CREDIT RECAPTURE AMOUNT.—For purposes of paragraph (1), the credit recapture amount is an amount equal to the sum of—

"(A) the aggregate decrease in the credits allowed to the taxpayer under section 38 for all prior taxable years which would have resulted if the accelerated portion of the credit allowable by reason of this section were not allowed for all

prior taxable years with respect to the excess of the amount described in paragraph (1)(B) over the amount dscribed in paragraph (1)(A), plus

"(B) interest at the overpayment rate established under section 6621 on the amount determined under subparagraph (A) for each prior taxable year for the period beginning on the due date for filing the return for the prior taxable year involved.

No deduction shall be allowed under this chapter for interest described in subparagraph (B).

"(3) ACCELERATED PORTION OF CREDIT.—For purposes of paragraph (2), the accelerated portion of the credit for the prior taxable years with respect to any amount of basis is the excess of—

"(A) the aggregate credit allowed by reason of this section (without regard to this subsection) for such years with respect to such basis, over

"(B) the aggregate credit which would be allowable by reason of this section for such years with respect to such basis if the aggregate credit which would (but for this subsection) have been allowable for the entire compliance period were allowable ratably over 15 years.

"(4) SPECIAL RULES.—

"(A) TAX BENEFIT RULE.—The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

"(B) ONLY BASIS FOR WHICH CREDIT ALLOWED TAKEN INTO ACCOUNT.—Qualified basis shall be taken into account under paragraph (1)(B) only to the extent such basis was taken into account in determining the credit under subsection (a) for the preceding taxable year referred to in such paragraph.

"(C) NO RECAPTURE OF ADDITIONAL CREDIT ALLOWABLE BY REASON OF SUBSECTION (F)(3).—Paragraph (1) shall apply to a decrease in qualified basis only to the extent such decrease exceeds the amount of qualified basis with respect to which a credit was allowable for the taxable year referred to in paragraph (1)(B) by reason of subsection (f)(3).

"(D) NO CREDITS AGAINST TAX.—Any increase in tax under this subsection shall not be treated as a tax imposed by this chapter for purposes of determining the amount of any credit under subpart A, B, or D of this part.

"(E) NO RECAPTURE BY REASON OF CASUALTY LOSS.—The increase in tax under this subsection shall not apply to a reduction in qualified basis by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

"(5) CERTAIN PARTNERSHIPS TREATED AS THE TAXPAYER.—

"(A) IN GENERAL.—For purposes of applying this subsection to a partnership to which this paragraph applies—

"(i) such partnership shall be treated as the taxpayer to which the credit allowable under subsection (a) was allowed,

"(ii) the amount of such credit allowed shall be treated as the amount which would have been allowed to the partnership were such credit allowable to such partnership,

"(iii) paragraph (4)(A) shall not apply, and

"(iv) the amount of the increase in tax under this subsection for any taxable year shall be allocated among the partners of such partnership in the same manner as such partnership's taxable income for such year is allocated among such partners.

"(B) PARTNERSHIPS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any partnership—

"(i) which has 35 or more partners each of whom is a natural person or an estate, and

"(ii) which elects the application of this paragraph.

"(C) SPECIAL RULES.—

"(i) HUSBAND AND WIFE TREATED AS 1 PARTNER.—For purposes of subparagraph (B)(i), a husband and wife (and their estates) shall be treated as 1 partner.

"(ii) ELECTION IRREVOCABLE.—Any election under subparagraph (B), once made, shall be irrevocable.

"(6) NO RECAPTURE ON DISPOSITION OF BUILDING WHERE BOND POSTED.—In the case of a disposition of a building, the taxpayer shall be discharged from liability for any additional tax under this subsection by reason of such disposition if—

"(A) the taxpayer furnishes to the Secretary a bond in an amount satifactory to the Secretary and for the period required by the Secretary, and

"(B) it is reasonably expected that such building will continue to be operated as a qualified low-income building for the remaining compliance period with respect to such building.

"(k) APPLICATION OF AT-RISK RULES.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, rules similar to the rules of section 46(c) (8) (other than subparagraph (D)(iv)(I) thereof), section 46(c)(9), and section 47(d)(1) shall apply in determining the qualified basis of any building in the same manner as such sections apply in determining the credit base of property.

"(2) SPECIAL RULES FOR DETERMINING QUALIFIED PERSON.—For purposes of paragraph (1)—

"(A) IN GENERAL.—If the requirements of subparagraphs (B), (C), and (D) are met with respect to any financing borrowed from a qualified nonprofit organization (as defined in subsection (h)(5)), the determination of whether such financing is qualified commercial financing with respect to any qualified low-income building shall be made without regard to whether such organization—

"(i) is actively and regularly engaged in the business of lending money, or

"(ii) is a person described in section 46(c)(8)(D)(iv)(II).

"(B) FINANCING SECURED BY PROPERTY.—The requirements of this subparagraph are met with respect to any financing if such financing is secured by the qualified low-income building.

"(C) PORTION OF BUILDING ATTRIBUTABLE TO FINANCING.—The requirements of this subparagraph are met with respect to any financing for any taxable year in the compliance period if, as of the close of such taxable year, not more than 60 percent of the eligible basis of the qualified low-income building is attributable to such financing (reduced by the principal and interest of any governmental financing which is part of a wrap-around mortgage involving such financing).

"(D) REPAYMENT OF PRINCIPAL AND INTEREST.—The requirements of this subparagraph are met with respect to any financing if such financing is fully repaid on or before the earliest of—

"(i) the date on which such financing matures,

"(ii) the 90th day after the close of the compliance period with respect to the qualified low-income building, or

"(iii) the date of its refinancing or the sale of the building to which such financing relates.

"(3) PRESENT VALUE OF FINANCING.—If the rate of interest on any financing described in paragraph (2)(A) is less than the rate which is 1 percentage point below the applicable Federal rate as of the time such financing is incurred, then the qualified basis (to which such financing relates) of the qualified low-income building shall be the present value of the amount of such financing, using as the discount rate such applicable Federal rate. For purposes of the preceding sentence, the rate of interest on any financing shall be determined by treating interest to the extent of government subsidies as not payable.

"(4) FAILURE TO FULLY REPAY.—

"(A) IN GENERAL.—To the extent that the requirements of paragraph (2)(D) are not met, then the taxpayer's tax under this chapter for the taxable year in which such failure occurs shall be increased by an amount equal to the applicable portion of the credit under this section with respect to such building, increased by an amount of interest for the period—

"(i) beginning with the due date for the filing of the return of tax imposed by chapter 1 for the 1st taxable year for which such credit was allowable, and

"(ii) ending with the due date for the taxable year in which such failure occurs,

determined by using the underpayment rate and method under section 6621.

"(B) APPLICABLE PORTION.—For purposes of subparagraph (A), the term 'applicable portion' means the aggregate decrease in the credits allowed to a taxpayer under section 38 for all prior taxable years which would have resulted if the eligible basis of the building were reduced by the

amount of financing which does not meet requirements of paragraph (2)(D).

"(C) CERTAIN RULES TO APPLY.—Rules similar to the rules of subparagraphs (A) and (D) of subsection (j)(4) shall apply for purposes of this subsection.

"(l) CERTIFICATIONS TO SECRETARY.—

"(1) CERTIFICATION WITH RESPECT TO 1ST YEAR OF CREDIT PERIOD.—Not later than the 90th day following the close of the 1st taxable year in the credit period with respect to any qualified low-income building, the taxpayer shall certify to the Secretary (in such form and in such manner as the Secretary prescribes)—

"(A) the taxable year, and calendar year, in which such building was placed in service,

"(B) the adjusted basis and eligible basis of such building as of the close of the 1st year of the credit period,

"(C) the maximum applicable percentage and qualified basis permitted to be taken into account by the appropriate housing credit agency under subsection (h),

"(D) the election made under subsection (g) with respect to the qualified low-income housing project of which such building is a part, and

"(E) such other information as the Secretary may require.

In the case of a failure to make the certification required by the preceding sentence on the date prescribed therefor, unless it is shown that such failure is due to reasonable cause and not to willful neglect, no credit shall be allowable by reason of subsection (a) with respect to such building for any taxable year ending before such certification is made.

"(2) ANNUAL REPORTS FROM HOUSING CREDIT AGENCIES.—Each agency which allocates any housing credit amount to any building for any calendar year shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual report specifying—

"(A) the amount of housing credit amount allocated to each building for such year, and

"(B) sufficient information to identify each such building and the taxpayer with respect thereto, and

"(C) such other information as the Secretary may require.

The penalty under section 6652(j) shall apply to any failure to submit the report required by the preceding sentence on the date prescribed therefor.

"(m) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations—

"(1) dealing with—

"(A) projects which include more than 1 building or only a portion of a building,

"(B) buildings which are placed in service in portions,

"(2) providing for the application of this section to short taxable years, and

"(3) preventing the avoidance of the rules of this section.

"(n) TERMINATION—.

(1) IN GENERAL.—Except as provided in parargraph (2), the State housing credit ceiling under subsection (h) shall be zero for any calendar year after 1989.

"(2) CARRYOVER OF 1989 LIMIT FOR CERTAIN PROJECTS IN PROGRESS.—

"(A) IN GENERAL.—The aggregate housing credit amount of any agency for 1989 which is not allocated for 1989 shall be treated for purposes of applying this section to any building described in subparagraph (B) as the housing credit amount of such agency for 1990.

"(B) DESCRIPTION.—A building is described in this subparagraph if—

"(i) such building is constructed, reconstructed, or rehabilitated by the taxpayer,

"(ii) more than 10 percent of the reasonably anticipated cost of such construction, reconstrcution, or rehabilitation has been incurred as of January 1, 1989, and

"(iii) such building is placed in service before January 1, 1991.

"(C) CERTAIN RULE NOT TO APPLY.—Subsection (h)(6)(B)(i) shall not apply for purposes of this paragraph."

(b) LOW-INCOME HOUSING CREDIT TREATED AS OTHER BUSINESS REDITS.—

(1) Subsection (b) of section 38 (relating to current year business credits), as amended by this Act, is amended by striking out "plus" at the end of paragraph (3), but striking out the period at the end of paragraph (4) and inserting in lieu thereof "plus", and by adding at the end thereof the following new paragraph:

"(5) the low-income housing credit determined under section 42(a)."

(2) Subsection (d) of section 38 is amended by inserting "42(a)," before "46(a)".

(c) RECAPTURE TAX NOT TO REDUCE MINIMUM TAX.—Paragraph) of section 55(c), as amended by section 701 of this Act, is amendd by inserting "or section 42(j)" after "section 47".

(d) CLERICAL AMENDMENT.—The table of sections for subpart D of art IV of subchapter A of chapter 1 is amended by adding at the nd thereof the following new item:

Sec. 42. Low-income housing credit."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to buildings placed in service after December 31, 1986, in taxable years ending after such date.

(2) SPECIAL RULE FOR REHABILITATION EXPENDITURES.—Subsection (e) of section 42 of the Internal Revenue Code of 1986 (as added by this section) shall apply for purposes of paragraph (1).

(f) TRANSITIONAL RULES.—

(1) LIMITATION TO NON-ACRS BUILDINGS NOT TO APPLY TO CERTAIN BUILDINGS, ETC.—

(A) IN GENERAL.—In the case of a building which is part of a project described in subparagraph (B)—

(i) section 42(c)(2)(B) of the Internal Revenue Code of 1986 (as added by this section) shall not apply, and

(ii) such building shall be treated as not federally subsidized for purposes of section 42(b)(1)(A) of such Code.

(B) Project described.—A project is described in this subparagraph if—

(i) an urban development action grant application with respect to such project was submitted on September 13, 1984,

(ii) a zoning commission map amendment related to such project was granted on July 17, 1985, and

(iii) the number assigned to such project by the Federal Housing Administration is 023-36602.

(C) Additional units eligible for credit.—In the case of a building to which subparagraph (A) applies and which is part of a project which meets the requirements of subparagraph (D), for each low-income unit in such building which is occupied by individuals whose income is 30 percent or less of area median gross income, one additional unit (not otherwise a low-income unit) in such building shall be treated as a low-income unit for purposes of such section 42.

(D) Project described.—A project is described in this subparagraph if—

(i) rents charged for units in such project are restricted by State regulations,

(ii) the annual cash flow of such project is restricted by State law,

(iii) the project is located on land owned by or ground leased from a public housing authority,

(iv) construction of such project begins on or before December 31, 1986, and units within such project are placed in service on or before June 1, 1990, and

(v) for a 20-year period, 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income.

(E) Maximum additional credit.—The maximum annual additional credit allowable under section 42 of such Code by reason of subparagraph (C) shall not exceed 25 percent of the eligible basis of the building.

(2) Additional allocation of housing credit ceiling.—

(A) In general.—There is hereby allocated to each housing credit agency described in subparagraph (B) an additional housing credit dollar amount determined in accordance with the following table:

For calendar year:	***The additional allocation is:***
1987	*$3,900,000*
1988	*$7,600,000*
1989	*$1,300,000*

(B) Housing credit agencies described.—The housing credit agencies described in this subparagraph are:

(i) A corporate governmental agency constituted as a public benefit corporation and established in 1971 under the provisions of Article XII of the Private Housing Finance Law of the State.

(ii) A city department established on December 20, 1979, pursuant to chapter XVIII of a municipal code of such city for the purpose of supervising and coordinating the formation and execution of projects and programs affecting housing within such city.

(iii) The State housing finance agency referred to in subparagraph (C), but only with respect to projects described in subparagraph (C).

(C) PROJECT DESCRIBED.—A project is described in this subparagraph if such project is a qualified low-income housing project which—

(i) receives financing from a State housing finance agency from the proceeds of bonds issued pursuant to chapter 708 of the Acts of 1966 of such State pursuant to loan commitments from such agency made between May 8, 1984, and July 8, 1986, and

(ii) is subject to subsidy commitments issued pursuant to a program established under chapter 574 of the Acts of 1983 of such State having award dates from such agency between May 31, 1984, and June 11, 1985.

(D) SPECIAL RULES.—

(i) Any building—

(I) which is allocated any housing credit dollar amount by a housing credit agency described in clause (iii) of subparagraph (B), and

(II) which is placed in service after June 30, 1986, and before January 1, 1987,

shall be treated for purposes of the amendments made by this section as placed in service on January 1, 1987.

(ii) Section 42(c)(2)(B) of the Internal Revenue Code of 1986 shall not apply to any building which is allocated any housing credit dollar amount by any agency described in subparagraph (B).

(E) ALL UNITS TREATED AS LOW INCOME UNITS IN CERTAIN CASES.—In the case of any building—

(i) which is allocated any housing credit dollar amount by any agency described in subparagraph (B), and

(ii) which after the application of subparagraph (D)(ii) is a qualified low-income building at all times during any taxable year,

such building shall be treated as described in section 42(b)(1)(B) of such Code and having an applicable fraction for such year of 1.

(3) CERTAIN PROJECTS PLACED IN SERVICE BEFORE 1987.—

(A) IN GENERAL.—In the case of a building which is part of a project described in subparagraph (B)—

(i) section 42(c)(2)(B) of such Code shall not apply,

(ii) such building shall be treated as placed in service during the first calendar year after 1986 and before

1990 in which such building is a qualified low-income building (determined after the application of clause (i)), and

(iii) for purposes of section 42(h) of such Code, such building shall be treated as having allocated to it a housing credit dollar amount equal to the dollar amount appearing in the clause of subparagraph (B) in which such building is described.

(B) PROJECT DESCRIBED.—A project is described in this subparagraph if the Code number assigned to such project by the Farmers' Home Administration appears in the following table:

The code number is:	***The housing credit dollar amount is:***
(i) 49284553664	*$16,000*
(ii) 4927742022446	*$22,000*
(iii) 492707422769087	*$64,000*
(iv) 490270742387293	*$48,000*
(v) 4927074218234	*$32,000*
(vi) 49270742274019	*$36,000*
(vii) 51460742345074	*$53,000.*

(C) DETERMINATION OF ADJUSTED BASIS.—The adjusted basis of any building to which this paragraph applies for purposes of section 42 of such Code shall be its adjusted basis as of the close of the taxable year ending before the first taxable year of the credit period for such building.

(D) CERTAIN RULES TO APPLY.—Rules similar to the rules of subparagraph (E) of paragraph (2) shall apply for purposes of this paragraph.

(4) DEFINITIONS.—For purposes of this subsection, terms used in such subsection which are also used in section 42 of the Internal Revenue Code of 1986 (as added by this section) shall have the meanings given such terms by such section 42.

Subtitle G—Merchant Marine Capital Construction Funds

SEC. 261. PROVISIONS RELATING TO MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS.

(a) PURPOSE.—The purpose of this section is to coordinate the application of the Internal Revenue Code of 1986 with the capital construction program under the Merchant Marine Act, 1936.

(b) AMENDMENT OF 1986 CODE.—Chapter 77 (relating to miscellaneous provisions) is amended by adding at the end thereof the following new section:

"SEC. 7518. TAX INCENTIVES RELATING TO MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS.

"(a) CEILING ON DEPOSITS.—

"(1) IN GENERAL.—The amount deposited in a fund established under section 607 of the Merchant Marine Act, 1936 (hereinafter in this section referred to as a 'capital construction fund') shall not exceed for any taxable year the sum of:

"(A) that portion of the taxable income of the owner or lessee for such year (computed as provided in chapter 1 but

without regard to the carryback of any net operating loss or net capital loss and without regard to this section) which is attributable to the operation of the agreement vessels in the foreign or domestic commerce of the United States or in the fisheries of the United States,

"(B) the amount allowable as a deduction under section 167 for such year with respect to the agreement vessels,

"(C) if the transaction is not taken into account for purposes of subparagraph (A), the net proceeds (as defined in joint regulations) from—

"(i) the sale or other disposition of any agreement vessel, or

"(ii) insurance or indemnity attributable to any agreement vessel, and

"(D) the receipts from the investment or reinvestment of amounts held in such fund.

"(2) LIMITATIONS ON DEPOSITS BY LESSEES.—In the case of a lessee, the maximum amount which may be deposited with respect to an agreement vessel by reason of paragraph (1)(B) for any period shall be reduced by any amount which, under an agreement entered into under section 607 of the Merchant Marine Act, 1936, the owner is required or permitted to deposit for such period with respect to such vessel by reason of paragraph (1)(B).

"(3) CERTAIN BARGES AND CONTAINERS INCLUDED.—For purposes of paragraph (1), the term 'agreement vessel' includes barges and containers which are part of the complement of such vessel and which are provided for in the agreement.

"(b) REQUIREMENTS AS TO INVESTMENTS.—

"(1) IN GENERAL.—Amounts in any capital construction fund shall be kept in the depository or depositories specified in the agreement and shall be subject to such trustee and other fiduciary requirements as may be specified by the Secretary.

"(2) LIMITATION ON FUND INVESTMENTS.—Amounts in any capital construction fund may be invested only in interest-bearing securities approved by the Secretary; except that, if such Secretary consents thereto, an agreed percentage (not in excess of 60 percent) of the assets of the fund may be invested in the stock of domestic corporations. Such stock must be currently fully listed and registered on an exchange registered with the Securities and Exchange Commission as a national securities exchange, and must be stock which would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and the preservation of their capital. If at any time the fair market value of the stock in the fund is more than the agreed percentage of the assets in the fund, any subsequent investment of amounts deposited in the fund, and any subsequent withdrawal from the fund, shall be made in such a way as to tend to restore the fund to a situation in which the fair market value of the stock does not exceed such agreed percentage.

"(3) INVESTMENT IN CERTAIN PREFERRED STOCK PERMITTED.—For purposes of this subsection, if the common stock of a corporation meets the requirements of this subsection and if the pre-

ferred stock of such corporation would meet such requirements but for the fact that it cannot be listed and registered as required because it is nonvoting stock, such preferred stock shall be treated as meeting the requirements of this subsection.

"(c) Nontaxability for Deposits.—

"(1) In general.—For purposes of this title—

"(A) taxable income (determined without regard to this section and section 607 of the Merchant Marine Act, 1936) for the taxable year shall be reduced by an amount equal to the amount deposited for the taxable year out of amounts referred to in subsection (a)(1)(A),

"(B) gain from a transaction referred to in subsection (a)(1)(C) shall not be taken into account if an amount equal to the net proceeds (as defined in joint regulations) from such transaction is deposited in the fund,

"(C) the earnings (including gains and losses) from the investment and reinvestment of amounts held in the fund shall not be taken into account,

"(D) the earnings and profits (within the meaning of section 316) of any corporation shall be determined without regard to this section and section 607 of the Merchant Marine Act, 1936, and

"(E) in applying the tax imposed by section 531 (relating to the accumulated earnings tax), amounts while held in the fund shall not be taken into account.

"(2) Only qualified deposits eligible for treatment.—Paragraph (1) shall apply with respect to any amount only if such amount is deposited in the fund pursuant to the agreement and not later than the time provided in joint regulations.

"(d) Establishment of Accounts.—For purposes of this section—

"(1) In general.—Within a capital construction fund 3 accounts shall be maintained:

"(A) the capital account,

"(B) the capital gain account, and

"(C) the ordinary income account.

"(2) Capital account.—The capital account shall consist of—

"(A) amounts referred to in subsection (a)(1)(B),

"(B) amounts referred to in subsection (a)(1)(C) other than that portion thereof which represents gain not taken into account by reason of subsection (c)(1)(B),

"(C) the percentage applicable under section 243(a)(1) of any dividend received by the fund with respect to which the person maintaining the fund would (but for subsection (c)(1)(C)) be allowed a deduction under section 243, and

"(D) interest income exempt from taxation under section 103.

"(3) Capital gain account.—The capital gain account shall consist of—

"(A) amounts representing capital gains on assets held for more than 6 months and referred to in subsection (a)(1)(C) or (a)(1)(D), reduced by

"(B) amounts representing capital losses on assets held in the fund for more than 6 months.

"(4) Ordinary income account.—The ordinary income account shall consist of—

"(A) amounts referred to in subsection (a)(1)(A),

"(B)(i) amounts representing capital gains on assets held for 6 months or less and referred to in subsection (a)(1)(C) or (a)(1)(D), reduced by

"(ii) amounts representing capital losses on assets held in the fund for 6 months or less,

"(C) interest (not including any tax-exempt interest referred to in paragraph (2)(D)) and other ordinary income (not including any dividend referred to in subparagraph (E)) received on assets held in the fund,

"(D) ordinary income from a transaction described in subsection (a)(1)(C), and

"(E) the portion of any dividend referred to in paragraph (2)(C) not taken into account under such paragraph.

"(5) Capital losses only allowed to offset certain gains.—Except on termination of a capital construction fund, capital losses referred to in paragraph (3)(B) or in paragraph (4)(B)(ii) shall be allowed only as an offset to gains referred to in paragraph (3)(A) or (4)(B)(i), respectively.

"(e) Purposes of Qualified Withdrawals.—

"(1) In general.—A qualified withdrawal from the fund is one made in accordance with the terms of the agreement but only if it is for:

"(A) the acquisition, construction, or reconstruction of a qualified vessel,

"(B) the acquisition, construction, or reconstruction of barges and containers which are part of the complement of a qualified vessel, or

"(C) the payment of the principal on indebtedness incurred in connection with the acquisition, construction, or reconstruction of a qualified vessel or a barge or container which is part of the complement of a qualified vessel.

Except to the extent provided in regulations prescribed by the Secretary, subparagraph (B), and so much of subparagraph (C) as relates only to barges and containers, shall apply only with respect to barges and containers constructed in the United States.

"(2) Penalty for failing to fulfill any substantial obligation.—Under joint regulations, if the Secretary determines that any substantial obligation under any agreement is not being fulfilled, he may, after notice and opportunity for hearing to the person maintaining the fund, treat the entire fund or any portion thereof as an amount withdrawn from the fund in a nonqualified withdrawal.

"(f) Tax Treatment of Qualified Withdrawals.—

"(1) Ordering rule.—Any qualified withdrawal from a fund shall be treated—

"(A) first as made out of the capital account,

"(B) second as made out of the capital gain account, and

"(C) third as made out of the ordinary income account.

"(2) Adjustment to basis of vessel, etc., where withdrawal from ordinary income account.—If any portion of a

qualified withdrawal for a vessel, barge, or container is made out of the ordinary income account, the basis of such vessel, barge, or container shall be reduced by an amount equal to such portion.

"(3) Adjustment to basis of vessel, etc., where withdrawal from capital gain account.—If any portion of a qualified withdrawal for a vessel, barge, or container is made out of the capital gain account, the basis of such vessel, barge, or container shall be reduced by an amount equal to such portion.

"(4) Adjustment to basis of vessels, etc., where withdrawals pay principal on debt.—If any portion of a qualified withdrawal to pay the principal on any indebtedness is made out of the ordinary income account or the capital gain account, then an amount equal to the aggregate reduction which would be required by paragraphs (2) and (3) if this were a qualified withdrawal for a purpose described in such paragraphs shall be applied, in the order provided in joint regulations, to reduce the basis of vessels, barges, and containers owned by the person maintaining the fund. Any amount of a withdrawal remaining after the application of the preceding sentence shall be treated as a nonqualified withdrawal.

"(5) Ordinary income recapture of basis reduction.—If any property the basis of which was reduced under paragraph (2), (3), or (4) is disposed of, any gain realized on such disposition, to the extent it does not exceed the aggregate reduction in the basis of such property under such paragraphs, shall be treated as an amount referred to in subsection (g)(3)(A) which was withdrawn on the date of such disposition. Subject to such conditions and requirements as may be provided in joint regulations, the preceding sentence shall not apply to a disposition where there is a redeposit in an amount determined under joint regulations which will, insofar as practicable, restore the fund to the position it was in before the withdrawal.

"(g) Tax Treatment of Nonqualified Withdrawals.—

"(1) In general.—Except as provided in subsection (h), any withdrawal from a capital construction fund which is not a qualified withdrawal shall be treated as a nonqualified withdrawal.

"(2) Ordering rule.—Any nonqualified withdrawal from a fund shall be treated—

"(A) first as made out of the ordinary income account,

"(B) second as made out of the capital gain account, and

"(C) third as made out of the capital account.

For purposes of this section, items withdrawn from any account shall be treated as withdrawn on a first-in-first-out basis; except that (i) any nonqualified withdrawal for research, development, and design expenses incident to new and advanced ship design, machinery and equipment, and (ii) any amount treated as a nonqualified withdrawal under the second sentence of subsection (f)(4), shall be treated as withdrawn on a last-in-first-out basis.

"(3) Operating rules.—For purposes of this title—

"(A) any amount referred to in paragraph (2)(A) shall be included in income as an item of ordinary income for the taxable year in which the withdrawal is made,

"(B) any amount referred to in paragraph (2)(B) shall be included in income for the taxable year in which the withdrawal is made as an item of gain realized during such year from the disposition of an asset held for more than 6 months, and

"(C) for the period on or before the last date prescribed for payment of tax for the taxable year in which this withdrawal is made—

"(i) no interest shall be payable under section 6601 and no addition to the tax shall be payable under section 6651,

"(ii) interest on the amount of the additional tax attributable to any item referred to in subparagraph (A) or (B) shall be paid at the applicable rate (as defined in paragraph (4)) from the last date prescribed for payment of the tax for the taxable year for which such item was deposited in the fund, and

"(iii) no interest shall be payable on amounts referred to in clauses (i) and (ii) of paragraph (2) or in the case of any nonqualified withdrawal arising from the application of the recapture provision of section 606(5) of the Merchant Marine Act of 1936 as in effect on December 31, 1969.

"(4) Interest rate.—For purposes of paragraph (3)(C)(ii), the applicable rate of interest for any nonqualified withdrawal—

"(A) made in a taxable year beginning in 1970 or 1971 is 8 percent, or

"(B) made in a taxable year beginning after 1971, shall be determined and published jointly by the Secretary of the Treasury or his delegate and the applicable Secretary and shall bear a relationship to 8 percent which the Secretaries determine under joint regulations to be comparable to the relationship which the money rates and investment yields for the calendar year immediately preceding the beginning of the taxable year bear to the money rates and investment yields for the calendar year 1970.

"(5) Amount not withdrawn from fund after 25 years from deposit taxed as nonqualified withdrawal.—

"(A) In general.—The applicable percentage of any amount which remains in a capital construction fund at the close of the 26th, 27th, 28th, 29th, or 30th taxable year following the taxable year for which such amount was deposited shall be treated as a nonqualified withdrawal in accordance with the following table:

"If the amount remains in the fund at the close of the—	*The applicable percentage is—*
26th taxable year	*20 percent*
27th taxable year	*40 percent*
28th taxable year	*60 percent*
29th taxable year	*80 percent*
30th taxable year	*100 percent.*

"(B) Earnings treated as deposits.—The earnings of any capital construction fund for any taxable year (other than net gains) shall be treated for purposes of this paragraph as an amount deposited for such taxable year.

"(C) Amounts committed treated as withdrawn.—For purposes of subparagraph (A), an amount shall not be treated as remaining in a capital construction fund at the close of any taxable year to the extent there is a binding contract at the close of such year for a qualified withdrawal of such amount with respect to an identified item for which such withdrawal may be made.

"(D) Authority to treat excess funds as withdrawn.—If the Secretary determines that the balance in any capital construction fund exceeds the amount which is appropriate to meet the vessel construction program objectives of the person who established such fund, the amount of such excess shall be treated as a nonqualified withdrawal under subparagraph (A) unless such person develops appropriate program objectives within 3 years to dissipate such excess.

"(E) Amounts in fund on January 1, 1987.—For purposes of this paragraph, all amounts in a capital construction fund on January 1, 1987, shall be treated as deposited in such fund on such date.

"(6) Nonqualified withdrawals taxed at highest marginal rate.—

"(A) In general.—In the case of any taxable year for which there is a nonqualified withdrawal (including any amount so treated under paragraph (5)), the tax imposed by chapter 1 shall be determined—

"(i) by excluding such withdrawal from gross income, and

"(ii) by increasing the tax imposed by chapter 1 by the product of the amount of such withdrawal and the highest rate of tax specified in section 1 (section 11 in the case of a corporation).

With respect to the portion of any nonqualified withdrawal made out of the capital gain account during a taxable year to which section 1(i) or 1201(a) applies, the rate of tax taken into account under the preceding sentence shall not exceed 28 percent (34 percent in the case of a corporation).

"(B) Tax benefit rule.—If any portion of a nonqualified withdrawal is properly attributable to deposits (other than earnings on deposits) made by the taxpayer in any taxable year which did not reduce the taxpayer's liability for tax under chapter 1 for any taxable year preceding the taxable year in which such withdrawal occurs—

"(i) such portion shall not be taken into account under subparagraph (A), and

"(ii) an amount equal to such portion shall be treated as allowed as a deduction under section 172 for the taxable year in which such withdrawal occurs.

"(C) Coordination with deduction for net operating losses.—Any nonqualified withdrawal excluded from gross *income under subparagraph (A) shall be excluded in determining taxable income under section 172(b)(2).*

"(h) Certain Corporate Reorganizations and Changes in Partnerships.—Under joint regulations—

"(1) a transfer of a fund from one person to another person in a transaction to which section 381 applies may be treated as if such transaction did not constitute a nonqualified withdrawal, and

"(2) a similar rule shall be applied in the case of a continuation of a partnership.

"(i) Definitions.—For purposes of this section, any term defined in section 607(k) of the Merchant Marine Act, 1936 which is also used in this section (including the definition of 'Secretary') shall have the meaning given such term by such section 607(k) as in effect on the date of the enactment of this section."

(c) Credits Not Allowed Against Increase in Tax.—Paragraph (2) of section 26(b) is amended by striking out "and" at the end of subparagraph (G), by striking out the period at the end of subparagraph (H) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(I) subparagraph (A) of section 7518(g)(6) (relating to nonqualified withdrawals from capital construction funds taxed at highest marginal rate)."

(d) Departmental Reports and Certification.—Section 607 of the Merchant Marine Act, 1936, is amended by adding at the end thereof the following new subsection:

"(m) Departmental Reports and Certification.—

"(1) In general.—For each calendar year, the Secretaries shall each provide the Secretary of the Treasury, within 120 days after the close of such calendar year, a written report with respect to those capital construction funds that are under their jurisdiction.

"(2) Contents of reports.—Each report shall set forth the name and taxpayer identification number of each person—

"(A) establishing a capital construction fund during such calendar year;

"(B) maintaining a capital construction fund as of the last day of such calendar year;

"(C) terminating a capital construction fund during such calendar year;

"(D) making any withdrawal from or deposit into (and the amounts thereof) a capital construction fund during such calendar year; or

"(E) with respect to which a determination has been made during such calendar year that such person has failed to fulfill a substantial obligation under any capital construction fund agreement to which such person is a party."

(e) Conforming Amendments.—

(1) Subparagraph (A) of section 607(d)(1) of the Merchant Marine Act, 1936 is amended by inserting "and section 7518 of such Code" after "this section".

(2) Subparagraph (D) of section 607(d)(1) of such Act is amended by inserting "and section 7518 of such Code" after "this section".

(3) Subparagraph (C) of section 607(e)(2) of such Act is amended by striking out "85 percent" and inserting in lieu thereof "the percentage applicable under section 243(a)(1) of the Internal Revenue Code of 1986".

(4) Subparagraph (E) of section 607(e)(4) of such Act is amended to read as follows:

"(E) the portion of any dividend referred to in paragraph (2)(C) not taken into account under such paragraph."

(5) Paragraph (3) of section 607(g) of such Act is amended to read as follows:

"(3) If any portion of a qualified withdrawal for a vessel, barge, or container is made out of the capital gain account, the basis of such vessel, barge, or container shall be reduced by an amount equal to such portion."

(6) Subsection (h) of section 607 of such Act is amended by adding at the end thereof the following new paragraphs:

"(5) AMOUNT NOT WITHDRAWN FROM FUND AFTER 25 YEARS FROM DEPOSIT TAXED AS NONQUALIFIED WITHDRAWAL.—

"(A) IN GENERAL.—The applicable percentage of any amount which remains in a capital construction fund at the close of the 26th, 27th, 28th, 29th, or 30th taxable year following the taxable year for which such amount was deposited shall be treated as a nonqualified withdrawal in accordance with the following table:

"If the amount remains in the fund at the close of the—	*The applicable percentage is—*
26th taxable year	*20 percent*
27th taxable year	*40 percent*
28th taxable year	*60 percent*
29th taxable year	*80 percent*
30th taxable year	*100 percent.*

"(B) EARNINGS TREATED AS DEPOSITS.—The earnings of any capital construction fund for any taxable year (other than net gains) shall be treated for purposes of this paragraph as an amount deposited for such taxable year.

"(C) AMOUNTS COMMITTED TREATED AS WITHDRAWN.—For purposes of subparagraph (A), an amount shall not be treated as remaining in a capital construction fund at the close of any taxable year to the extent there is a binding contract at the close of such year for a qualified withdrawal of such amount with respect to an identified item for which such withdrawal may be made.

"(D) AUTHORITY TO TREAT EXCESS FUNDS AS WITHDRAWN.—If the Secretary determines that the balance in any capital construction fund exceeds the amount which is appropriate to meet the vessel construction program objectives of the person who established such fund, the amount of such excess shall be treated as a nonqualified withdrawal under subparagraph (A) unless such person develops appropriate program objectives within 3 years to dissipate such excess.

"(E) AMOUNTS IN FUND ON JANUARY 1, 1987.—For purposes of this paragraph, all amounts in a capital construction fund on January 1, 1987, shall be treated as deposited in such fund on such date.

"(6) NONQUALIFIED WITHDRAWALS TAXED AT HIGHEST MARGINAL RATE.—

"(A) IN GENERAL.—In the case of any taxable year for which there is a nonqualified withdrawal (including any amount so treated under paragraph (5)), the tax imposed by chapter 1 of the Internal Revenue Code of 1986 shall be determined—

"(i) by excluding such withdrawal from gross income, and

"(ii) by increasing the tax imposed by chapter 1 of such Code by the product of the amount of such withdrawal and the highest rate of tax specified in section 1 (section 11 in the case of a corporation) of such Code.

With respect to the portion of any nonqualified withdrawal made out of the capital gain account during a taxable year to which section 1(i) or 1201(a) of such Code applies, the rate of tax taken into account under the preceding sentence shall not exceed 28 percent (34 percent in the case of a corporation).

"(B) TAX BENEFIT RULE.—If any portion of a nonqualified withdrawal is properly attributable to deposits (other than earnings on deposits) made by the taxpayer in any taxable year which did not reduce the taxpayer's liability for tax under chapter 1 for any taxable year preceding the taxable year in which such withdrawal occurs—

"(i) such portion shall not be taken into account under subparagraph (A), and

"(ii) an amount equal to such portion shall be treated as allowed as a deduction under section 172 of such Code for the taxable year in which such withdrawal occurs.

"(C) COORDINATION WITH DEDUCTION FOR NET OPERATING LOSSES.—Any nonqualified withdrawal excluded from gross income under subparagraph (A) shall be excluded in determining taxable income under section 172(b)(2) of the Internal Revenue Code of 1986."

(f) CLERICAL AMENDMENT.—The table of sections for chapter 77 is amended by adding at the end thereof the following new item:

"Sec. 7518. Tax incentives relating to merchant marine capital construction funds."

(g) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

TITLE III—CAPITAL GAINS

Subtitle A—Individual Capital Gains

SEC. 301. REPEAL OF EXCLUSION FOR LONG-TERM CAPITAL GAINS OF INDIVIDUALS.

(a) IN GENERAL.—Section 1202 (relating to deduction for capital gains) is hereby repealed.

(b) CONFORMING AMENDMENTS.—

(1) Section 62(a) (defining adjusted gross income), as amended by section 132, is amended by striking out paragraph (3) and redesignating paragraphs (4), (5), (6), (7), (10), (11), (12), (13), (14), and (15) as paragraphs (3) through (12), respectively.

(2) Section 170(e)(1) (relating to certain contributions of ordinary income and capital gain property) is amended by striking out "40 percent (28/46 in the case of a corporation) of".

(3) Paragraph (2) of section 172(d) (relating to modifications with respect to net operating loss deduction) is amended to read as follows:

"(2) CAPITAL GAINS AND LOSSES OF TAXPAYERS OTHER THAN CORPORATIONS.—In the case of a taxpayer other than a corporation, the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets."

(4) Paragraph (1) of section 219(f) (defining compensation) is amended by striking out "paragraph (7)" and inserting in lieu thereof "paragraph (6)".

(5)(A) Section 223 (relating to cross references) is amended to read as follows:

"SEC. 223. CROSS REFERENCE.

"For deductions in respect of a decedent, see section 691."

(B) The table of sections for part VII of subchapter B of chapter 1 is amended by striking out "references" in the item relating to section 223 and inserting in lieu thereof "reference".

(6) Paragraph (4) of section 642(c) (relating to deduction for amounts paid or permanently set aside for a charitable purpose) is amended—

(A) by striking out the 1st sentence, and

(B) by striking out "ADJUSTMENTS" in the paragraph heading and inserting in lieu thereof "COORDINATION WITH SECTION 681".

(7) Paragraph (3) of section 643(a) (relating to distributable net income) is amended by striking out the last sentence.

(8) Paragraph (4) of section 691(c) (relating to deduction for estate tax) is amended—

(A) by striking out "1201, 1202, and 1211, and for purposes of section 57(a)(9)" and inserting in lieu thereof "1(j), 1201, and 1211", and

(B) by striking out "CAPITAL GAIN DEDUCTION, ETC.—" in the paragraph heading and inserting in lieu thereof "CAPITAL GAIN PROVISIONS.—".

(9) The second sentence of paragraph (2) of section 871(a) (relating to income not connected with United States business) is amended by striking out "such gains and losses shall be determined without regard to section 1202 (relating to deduction for capital gains) and".

(10) Subsection (b) of section 1211 (relating to limitation on capital losses) is amended to read as follows:

"(b) OTHER TAXPAYERS.—In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the lower of—

"(1) $3,000 ($1,500 in the case of a married individual filing a separate return), or

"(2) the excess of such losses over such gains."

(11) Paragraph (2) of section 1212(b) (relating to capital loss carrybacks and carryovers) is amended to read as follows:

"(2) SPECIAL RULE.—For purposes of determining the excess referred to in subparagraph (A) or (B) of paragraph (1), an amount equal to the amount allowed for the taxable year under paragraph (1) or (2) of section 1211(b) shall be treated as a short-term capital gain in such year."

(12) Paragraph (1) of section 1402(i) (relating to special rules for options and commodities dealers) is amended to read as follows:

"(1) IN GENERAL.—Notwithstanding subsection (a)(3)(A), in determining the net earnings from self-employment of any options dealer or commodities dealer, there shall not be excluded any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from section 1256 contracts or property related to such contracts."

(13) The table of sections for part I of subchapter P of chapter 1 is amended by striking out the item relating to section 1202.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 302. 28-PERCENT CAPITAL GAINS RATE FOR TAXPAYERS OTHER THAN CORPORATIONS.

(a) IN GENERAL.—Section 1 (relating to tax imposed on individuals), as amended by sections 101 and 1411, is amended by adding at the end thereof the following new subsection:

"(j) MAXIMUM CAPITAL GAINS RATE.—

"(1) IN GENERAL.—If a taxpayer has a net capital gain for any taxable year to which this subsection applies, then the tax imposed by this section shall not exceed the sum of—

"(A) a tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of—

"(i) the taxable income reduced by the amount of net capital gain, or

"(ii) the amount of taxable income taxed at a rate below 28 percent, plus

"(B) a tax of 28 percent of the amount of taxable income in excess of the amount determined under subparagraph (A), plus

"(C) the amount of increase determined under subsection (g).

"(2) Years to which subsection applies.—This subsection shall apply to—

"(A) any taxable year beginning in 1987, and

"(B) any taxable year beginning after 1987 if the highest rate of tax set forth in subsection (a), (b), (c), (d), or (e) (whichever applies) for such taxable year exceeds 28 percent."

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning after December 31, 1986.

(c) Transitional Rule.—The tax under section 1 of the Internal Revenue Code of 1986 on the long-term capital gain on rights to royalties paid under leases and assignments binding on September 25, 1985, by a limited partnership formed on March 1, 1977, which on October 30, 1979, assigned leases and which assignment was amended on April 27, 1981, shall not exceed 20 percent.

Subtitle B—Repeal of Corporate Capital Gains Treatment

SEC. 311. REPEAL OF CORPORATE CAPITAL GAINS TREATMENT.

(a) General Rule.—Section 1201 (relating to alternative tax for corporations) is amended to read as follows:

"SEC. 1201. ALTERNATIVE TAX FOR CORPORATIONS.

"(a) General Rule.—If for any taxable year a corporation has a net capital gain and any rate of tax imposed by section 11, 511, or 831(a) (whichever is applicable) exceeds 34 percent (determined without regard to the last sentence of section 11(b)), then, in lieu of any such tax, there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

"(1) a tax computed on the taxable income reduced by the amount of the net capital gain, at the rates and in the manner as if this subsection had not been enacted, plus

"(2) a tax of 34 percent of the net capital gain.

"(b) Cross References.—

"For computation of the alternative tax—

"(1) in the case of life insurance companies, see section 801(a)(2),

"(2) in the case of regulated investment companies and their shareholders, see section 852(b)(3)(A) and (D), and

"(3) in the case of real estate investment trusts, see section 857(b)(3)(A)."

(b) Technical Amendments.—

(1) Clause (iii) of section 852(b)(3)(D) is amended by striking out "72 percent" and inserting in lieu thereof "66 percent".

(2) Subparagraph (E) of section 593(b)(2), as in effect before the amendments made by title IX, is amended by adding "and" at the end of clause (iii), by striking out clause (iv), and by redesignating clause (v) as clause (iv).

(3) The second sentence of section 631(c) is amended by striking out "Such owner" and inserting in lieu thereof "If for the taxable year of such gain or loss the maximum rate of tax im-

posed by this chapter on any net capital gain is less than such maximum rate for ordinary income, such owner".

(4) Paragraphs (1) and (2) of section 1445(e) (as amended by title XVIII) are each amended by striking out "28 percent" and inserting in lieu thereof "34 percent".

(c) Effective Date.—The amendments made by subsections (a) and (b) shall apply to taxable years beginning after December 31, 1986.

(d) Transitional Rules.—

(1) Taxable years which begin in 1986 and end in 1987.—In the case of any taxable year which begins before January 1, 1987, and ends on or after such date, paragraph (2) of section 1201(a) of the Internal Revenue Code of 1954, as in effect on the date before the date of enactment of this Act, shall be applied as if it read as follows:

"(2) the sum of—

"(A) 28 percent of the lesser of—

"(i) the net capital gain determined by taking into account only gain or loss which is properly taken into account for the portion of the taxable year before January 1, 1987, or

"(ii) the net capital gain for the taxable year, and

"(B) 34 percent of the excess (if any) of—

"(i) the net capital gain for the taxable year, over

"(ii) the amount of the net capital gain taken into account under subparagraph (A)."

(2) Revocation of elections under section 631(a).—Any election under section 631(a) of the Internal Revenue Code of 1954 made (whether by a corporation or a person other than a corporation) for a taxable year beginning before January 1, 1987, may be revoked by the taxpayer for any taxable year ending after December 31, 1986. For purposes of determining whether the taxpayer may make a further election under such section, such election (and any revocation under this paragraph) shall not be taken into account.

Subtitle C—Incentive Stock Options

SEC. 321. REPEAL OF REQUIREMENT THAT INCENTIVE STOCK OPTIONS ARE EXERCISABLE ONLY IN CHRONOLOGICAL ORDER; MODIFICATION OF $100,000 LIMITATION.

(a) General Rule.—Subsection (b) of section 422A is amended by inserting "and" at the end of paragraph (6) and by striking out paragraphs (7) and (8) and inserting in lieu thereof the following new paragraph:

"(7) under the terms of the plan the aggregate fair market value (determined at the time the option is granted) of the stock with respect to which incentive stock options are exercisable for the 1st time by such individual during any calendar year (under all such plans of the individual's employer corporation and its parent and subsidiary corporations) shall not exceed $100,000."

(b) Conforming Amendments.—

(1) Subsection (c) of section 422A is amended—

(A) by striking out paragraphs (4) and (7), and

(B) by redesignating paragraphs (5), (6), (8), (9), and (10) as paragraphs (4), (5), (6), (7), and (8), respectively.

(2) The last sentence of section 422A(c)(1) is amended by striking out "paragraph (8) of subsection (b) and paragraph (4) of this subsection" and inserting in lieu thereof "paragraph (7) of subsection (b)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to options granted after December 31, 1986.

Subtitle D—Straddles

SEC. 331. YEAR-END RULE EXPANDED.

(a) IN GENERAL.—Subparagraph (E) of section 1092(c)(4) (defining straddle) is amended—

(1) by inserting "or the stock is disposed of at a loss" in clause (i) after "closed",

(2) by striking out "is" in clause (ii) and inserting in lieu thereof "or gains on such options are", and

(3) by inserting "or option" after "stock" and "or the disposition of such stock" after "options" in clause (iii).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to positions established on or after January 1, 1987.

TITLE IV—AGRICULTURE, ENERGY, AND NATURAL RESOURCES

Subtitle A—Agriculture

SEC. 401. LIMITATION ON EXPENSING OF SOIL AND WATER CONSERVATION EXPENDITURES.

(a) GENERAL RULE.—Subsection (c) of section 175 (relating to soil and water conservation expenditures) is amended by adding at the end thereof the following new paragraph:

"(3) ADDITIONAL LIMITATIONS.—

"(A) EXPENDITURES MUST BE CONSISTENT WITH SOIL CONSERVATION PLAN.—Notwithstanding any other provision of this section, subsection (a) shall not apply to any expenditures unless such expenditures are consistent with—

"(i) the plan (if any) approved by the Soil Conservation Service of the Department of Agriculture for the area in which the land is located, or

"(ii) if there is no plan described in clause (i), any soil conservation plan of a comparable State agency.

"(B) CERTAIN WETLAND, ETC., ACTIVITIES NOT QUALIFIED.—Subsection (a) shall not apply to any expenditures in connection with the draining or filling of wetlands or land preparation for center pivot irrigation systems."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts paid or incurred after December 31, 1986, in taxable years ending after such date.

SEC. 402. REPEAL OF SPECIAL TREATMENT FOR EXPENDITURES FOR CLEARING LAND.

(a) IN GENERAL.—Section 182 (relating to expenditures by farmers for clearing land) is hereby repealed.

(b) TECHNICAL AMENDMENTS.—

(1) Paragraph (1) of section 263(a) (relating to capital expenditures) is amended by striking out subparagraph (E) and by redesignating subparagraphs (F), (G), and (H) as subparagraphs (E), (F), and (G), respectively.

(2) Subparagraph (A) of section 1252(a)(1) (relating to gain from disposition of farm land) is amended by striking out "(relating to expenditures by farmers for clearing land)" and inserting in lieu thereof "(as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)".

(3) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 182.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after December 31, 1985, in taxable years ending after such date.

SEC. 403. TREATMENT OF DISPOSITIONS OF CONVERTED WETLANDS OR HIGHLY ERODIBLE CROPLANDS.

(a) GENERAL RULE.—Part IV of subchapter P of chapter 1 (relating to special rules for determining capital gains and losses) is amended by adding at the end thereof the following new section:

"SEC. 1257. DISPOSITION OF CONVERTED WETLANDS OR HIGHLY ERODIBLE CROPLANDS.

"(a) GAIN TREATED AS ORDINARY INCOME.—Any gain on the disposition of converted wetland or highly erodible cropland shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle, except that this section shall not apply to the extent such gain is recognized as ordinary income under any other provision of this part.

"(b) LOSS TREATED AS LONG-TERM CAPITAL LOSS.—Any loss recognized on the disposition of converted wetland or highly erodible cropland shall be treated as a long-term capital loss.

"(c) DEFINITIONS.—For purposes of this section—

"(1) CONVERTED WETLAND.—The term 'converted wetland' means any converted wetland (as defined in section 1201(4) of the Food Security Act of 1985 (16 U.S.C. 3801(4))) held—

"(A) by the person whose activities resulted in such land being converted wetland, or

"(B) by any other person who at any time used such land for farming purposes.

"(2) HIGHLY ERODIBLE CROPLAND.—The term 'highly erodible cropland' means any highly erodible cropland (as defined in section 1201(6) of the Food Security Act of 1985 (16 U.S.C. 3801(6))), if at any time the taxpayer used such land for farming purposes (other than the grazing of animals).

"(3) TREATMENT OF SUCCESSORS.—If any land is converted wetland or highly erodible cropland in the hands of any person, such land shall be treated as converted wetland or highly erodible cropland in the hands of any other person whose adjusted basis in such land is determined (in whole or in part) by refer-

ence to the adjusted basis of such land in the hands of such person.

"(d) SPECIAL RULES.—Under regulations prescribed by the Secretary, rules similar to the rules applicable under section 1245 shall apply for purposes of subsection (a). For purposes of sections 170(e), 341(e)(12), and 751(c), amounts treated as ordinary income under subsection (a) shall be treated in the same manner as amounts treated as ordinary income under section 1245."

(b) CLERICAL AMENDMENT.—The table of sections for part IV of subchapter P of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 1257. Disposition of converted wetlands or highly erodible croplands."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions of converted wetland or highly erodible cropland (as defined in section 1257(c) of the Internal Revenue Code of 1986 as added by this section) first used for farming after March 1, 1986, in taxable years ending after that date.

SEC. 404. LIMITATION ON CERTAIN PREPAID FARMING EXPENSES.

(a) GENERAL RULE.—Section 464 (relating to limitations on deductions in case of farming syndicates) is amended by adding at the end thereof the following new subsection:

"(f) SUBSECTIONS (a) AND (b) TO APPLY TO CERTAIN PERSONS PREPAYING 50 PERCENT OR MORE OF CERTAIN FARMING EXPENSES.—

"(1) IN GENERAL.—In the case of a taxpayer to whom this subsection applies, subsections (a) and (b) shall apply to the excess prepaid farm supplies of such taxpayer in the same manner as if such taxpayer were a farming syndicate.

"(2) TAXPAYER TO WHOM SUBSECTION APPLIES.—This subsection applies to any taxpayer for any taxable year if such taxpayer—

"(A) does not use an accrual method of accounting,

"(B) has excess prepaid farm supplies for the taxable year, and

"(C) is not a qualified farm-related taxpayer.

"(3) QUALIFIED FARM-RELATED TAXPAYER.—

"(A) IN GENERAL.—For purposes of this subsection, the term 'qualified farm-related taxpayer' means any farm-related taxpayer if—

"(i)(I) the aggregate prepaid farm supplies for the 3 taxable years preceding the taxable year are less than 50 percent of,

"(II) the aggregate deductible farming expenses (other than prepaid farm supplies) for such 3 taxable years, or

"(ii) the taxpayer has excess prepaid farm supplies for the taxable year by reason of any change in business operation directly attributable to extraordinary circumstances.

"(B) FARM-RELATED TAXPAYER.—For purposes of this paragraph, the term 'farm-related taxpayer' means any taxpayer—

"(i) whose principal residence (within the meaning of section 1034) is on a farm,

"(ii) who has a principal occupation of farming, or

"(iii) who is a member of the family (within the meaning of subsection (c)(2)(E)) of a taxpayer described in clause (i) or (ii).

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) EXCESS PREPAID FARM SUPPLIES.—The term 'excess prepaid farm supplies' means the prepaid farm supplies for the taxable year to the extent the amount of such supplies exceeds 50 percent of the deductible farming expenses for the taxable year (other than prepaid farm supplies).

"(B) PREPAID FARM SUPPLIES.—The term 'prepaid farm supplies' means any amounts which are described in subsection (a) or (b) and would be allowable for a subsequent taxable year under the rules of subsections (a) and (b).

"(C) DEDUCTIBLE FARMING EXPENSES.—The term 'deductible farming expenses' means any amount allowable as a deduction under this chapter (including any amount allowable as a deduction for depreciation or amortization) which is properly allocable to the trade or business of farming."

(b) CONFORMING AMENDMENTS.—

*(1) The heading for section 464 is amended by striking out "**IN CASE OF FARMING SYNDICATES**" and inserting in lieu thereof "**FOR CERTAIN FARMING**".*

(2) The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by striking out "in case of farming syndicates" in the item relating to section 464 and inserting in lieu thereof "for certain farming expenses".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after March 1, 1986, in taxable years beginning after such date.

SEC. 405. TAX TREATMENT OF DISCHARGE OF CERTAIN INDEBTEDNESS OF SOLVENT FARMERS.

(a) IN GENERAL.—Section 108 (relating to income from discharge of indebtedness) is amended by adding at the end thereof the following new subsection:

"(g) SPECIAL RULES FOR DISCHARGE OF QUALIFIED FARM INDEBTEDNESS OF SOLVENT FARMERS.—

"(1) IN GENERAL.—For purposes of this section and section 1017, the discharge by a qualified person of qualified farm indebtedness of a taxpayer who is not insolvent at the time of the discharge shall be treated in the same manner as if the discharge had occurred when the taxpayer was insolvent.

"(2) QUALIFIED FARM INDEBTEDNESS.—For purposes of this subsection, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if—

"(A) such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and

"(B) 50 percent or more of the average annual gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

"(3) QUALIFIED PERSON.—For purposes of this subsection, the term 'qualified person' means a person described in section 46(c)(8)(D)(iv)."

(b) BASIS ADJUSTMENT.—Section 1017(b) (relating to basis adjustment) is amended by adding at the end thereof the following new paragraph:

"(4) ORDERING RULE IN THE CASE OF QUALIFIED FARM INDEBTEDNESS.—Any amount which is excluded from gross income under section 108(a) by reason of the discharge of qualified farm indebtedness (within the meaning of section 108(g)(2)) and which under subsection (b) of section 108 is to be applied to reduce basis shall be applied—

"(A) first to reduce the tax attributes described in section 108(b)(2) (other than subparagraph (D) thereof),

"(B) then to reduce basis of property other than property described in subparagraph (C), and

"(C) then to reduce the basis of land used or held for use in the trade or business of farming."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to discharges of indebtedness occurring after April 9, 1986, in taxable years ending after such date.

SEC. 406. RETENTION OF CAPITAL GAINS TREATMENT FOR SALES OF DAIRY CATTLE UNDER MILK PRODUCTION TERMINATION PROGRAM.

The amendments made by subtitles A and B of title III shall not apply to any gain from the sale of dairy cattle under a valid contract with the United States Department of Agriculture under the milk production termination program to the extent such gain is properly taken into account under the taxpayer's method of accounting after January 1, 1987, and before September 1, 1987.

Subtitle B—Treatment of Oil, Gas, Geothermal, and Hard Minerals

SEC. 411. TREATMENT OF INTANGIBLE DRILLING COSTS AND MINERAL EXPLORATION AND DEVELOPMENT COSTS.

(a) TREATMENT UNDER SECTION 291.—

(1) INCREASE IN PERCENTAGE DISALLOWANCE.—Paragraph (1) of section 291(b) (relating to special rules for treatment of intangible drilling costs and mineral exploration and development costs) is amended by striking out "20 percent" and inserting in lieu thereof "30 percent".

(2) TREATMENT OF DISALLOWED AMOUNT.—Subsection (b) of section 291 is amended by striking out paragraphs (2), (3), (4), (5), and (6) and inserting in lieu thereof the following new paragraphs:

"(2) AMORTIZATION OF AMOUNTS NOT ALLOWABLE AS DEDUCTIONS UNDER PARAGRAPH (1).—The amount not allowable as a deduction under section 263(c), 616(a), or 617(a) (as the case may be) for any taxable year by reason of paragraph (1) shall be allowable as a deduction ratably over the 60-month period beginning with the month in which the costs are paid or incurred.

"(3) Dispositions.—For purposes of section 1254, any deduction under paragraph (2) shall be treated as a deduction allowable under section 263(c), 616(a), or 617(a) (whichever is appropriate).

"(4) Integrated oil company defined.—For purposes of this subsection, the term 'integrated oil company' means, with respect to any taxable year, any producer (within the meaning of section 4996(a)(1)) of crude oil other than an independent producer (within the meaning of section 4992(b)).

"(5) Coordination with cost depletion.—The portion of the adjusted basis of any property which is attributable to amounts to which paragraph (1) applied shall not be taken into account for purposes of determining depletion under section 611."

(b) Treatment of Costs Incurred Outside the United States.—

(1) Intangible drilling and development costs.—

(A) In general.—Section 263 (relating to capital expenditures) is amended by adding at the end thereof the following new subsection:

"(i) Special Rules for Intangible Drilling and Development Costs Incurred Outside the United States.—In the case of intangible drilling and development costs paid or incurred with respect to an oil, gas, or geothermal well located outside the United States—

"(1) subsection (c) shall not apply, and

"(2) such costs shall—

"(A) at the election of the taxpayer, be included in adjusted basis for purposes of computing the amount of any deduction allowable under section 611 (determined without regard to section 613), or

"(B) if subparagraph (A) does not apply, be allowed as a deduction ratably over the 10-taxable year period beginning with the taxable year in which such costs were paid or incurred.

This subsection shall not apply to costs paid or incurred with respect to a nonproductive well."

(B) Conforming amendment.—Section 263(c) is amended by inserting "and except as provided in subsection (i)," after "subsection (a),".

(2) Development and mining exploration costs.—

(A) In general.—Section 616 (relating to development expenditures) is amended by redesignating subsection (d) as subsection (e), and inserting after subsection (c) the following new subsection:

"(d) Special Rules for Foreign Development.—In the case of any expenditures paid or incurred with respect to the development of a mine or other natural deposit (other than an oil, gas, or geothermal well) located outside of the United States—

"(1) subsections (a) and (b) shall not apply, and

"(2) such expenditures shall—

"(A) at the election of the taxpayer, be included in adjusted basis for purposes of computing the amount of any deduction allowable under section 611 (without regard to section 613), or

"(B) if subparagraph (A) does not apply, be allowed as a deduction ratably over the 10-taxable year period beginning with the taxable year in which such expenditures were paid or incurred."

(B) CERTAIN MINING EXPLORATION EXPENDITURES OUTSIDE THE UNITED STATES.—Section 617(h) (relating to limitation) is amended to read as follows:

"(h) SPECIAL RULES FOR FOREIGN EXPLORATION.—In the case of any expenditures paid or incurred before the development stage for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (other than an oil, gas, or geothermal well) located outside the United States—

"(1) subsection (a) shall not apply, and

"(2) such expenditures shall—

"(A) at the election of the taxpayer, be included in adjusted basis for purposes of computing the amount of any deduction allowable under section 611 (without regard to section 613), or

"(B) if subparagraph (A) does not apply, be allowed as a deduction ratably over the 10-taxable year period beginning with the taxable year in which such expenditures were paid or incurred."

(C) CONFORMING AMENDMENTS.—

(i) Subsection (a) of section 616 is amended by striking out "subsection (b)" and inserting in lieu thereof "subsections (b) and (d)".

(ii) Subparagraph (B) of section 291(b)(1) is amended by striking out "617" and inserting in lieu thereof "617(a)".

(iii) Paragraph (10) of section 381(c) is amended by striking out the last sentence thereof.

(iv) Subparagraph (C) of section 243(b)(3) is amended—

(I) by adding "and" at the end of clause (i),

(II) by striking out clause (ii), and

(III) by redesignating clause (iii) as clause (ii).

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to costs paid or incurred after December 31, 1986, in taxable years ending after such date.

(2) TRANSITION RULE.—The amendments made by this section shall not apply with respect to intangible drilling and development costs incurred by United States companies pursuant to a minority interest in a license for Netherlands or United Kingdom North Sea development if such interest was acquired on or before December 31, 1985.

SEC. 412. MODIFICATION OF PERCENTAGE DEPLETION RULES.

(a) PERCENTAGE DEPLETION NOT ALLOWED FOR LEASE BONUSES, ETC.—

(1) IN GENERAL.—Subsection (d) of section 613A (relating to limitations on application of subsection (c)) is amended by adding at the end thereof the following new paragraph:

"(5) Percentage depletion not allowed for lease bonuses, etc.—In the case of any oil or gas property to which subsection (c) applies, for purposes of section 613, the term 'gross income from the property' shall not include any lease bonus, advance royalty, or other amount payable without regard to production from property."

(2) Geothermal deposits.—Section 613(e) is amended by adding at the end thereof the following new paragraph:

"(4) Percentage depletion not to include lease bonuses, etc.—In the case of any geothermal deposit, the term 'gross income from the property' shall, for purposes of this section, not include any amount described in section 613A(d)(5)."

(3) Effective date.—The amendment made by this subsection shall apply to amounts received or accrued after August 16, 1986, in taxable years ending after such date.

(b) Treatment Under Section 291 of Coal and Iron Ore.—

(1) In general.—Paragraph (2) of section 291(a) (relating to reductions in percentage depletion) is amended by striking out "15 percent" and inserting in lieu thereof "20 percent".

(2) Effective date.—The amendment made by paragraph (1) shall apply to taxable years beginning after December 31, 1986.

SEC. 413. GAIN FROM DISPOSITION OF INTERESTS IN OIL, GAS, GEOTHERMAL, OR OTHER MINERAL PROPERTIES.

(a) General Rule.—Section 1254 is amended to read as follows:

"SEC. 1254. GAIN FROM DISPOSITION OF INTEREST IN OIL, GAS, GEOTHERMAL, OR OTHER MINERAL PROPERTIES.

"(a) General Rule.—

"(1) Ordinary income.—If any section 1254 property is disposed of, the lesser of—

"(A) the aggregate amount of—

"(i) expenditures which have been deducted by the taxpayer or any person under section 263, 616, or 617 with respect to such property and which, but for such deduction, would have been included in the adjusted basis of such property, and

"(ii) the deductions for depletion under section 611 which reduced the adjusted basis of such property, or

"(B) the excess of—

"(i) in the case of—

"(I) a sale, exchange, or involuntary conversion, the amount realized, or

"(II) in the case of any other disposition, the fair market value of such property, over

"(ii) the adjusted basis of such property,

shall be treated as gain which is ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle.

"(2) Disposition of portion of property.—For purposes of paragraph (1)—

"(A) In the case of the disposition of a portion of section 1254 property (other than an undivided interest), the entire amount of the aggregate expenditures or deductions described in paragraph (1)(A) with respect to such property

shall be treated as allocable to such portion to the extent of the amount of the gain to which paragraph (1) applies.

"(B) In the case of the disposition of an undivided interest in a section 1254 property (or a portion thereof), a proportionate part of the expenditures or deductions described in paragraph (1)(A) with respect to such property shall be treated as allocable to such undivided interest to the extent of the amount of the gain to which paragraph (1) applies.

This paragraph shall not apply to any expenditures to the extent the taxpayer establishes to the satisfaction of the Secretary that such expenditures do not relate to the portion (or interest therein) disposed of.

"(3) Section 1254 property.—The term 'section 1254 property' means any property (within the meaning of section 614) if—

"(A) any expenditures described in paragraph (1)(A) are properly chargeable to such property, or

"(B) the adjusted basis of such property includes adjustments for deductions for depletion under section 611.

"(b) Special Rules Under Regulations.—Under regulations prescribed by the Secretary—

"(1) rules similar to the rule of subsection (g) of section 617 and to the rules of subsections (b) and (c) of section 1245 shall be applied for purposes of this section; and

"(2) in the case of the sale or exchange of stock in an S corporation, rules similar to the rules of section 751 shall be applied to that portion of the excess of the amount realized over the adjusted basis of the stock which is attributable to expenditures referred to in subsection (a)(1)(A) of this section."

(b) Coordination With Section 617(d).—Subsection (d) of section 617 is amended by adding at the end thereof the following new paragraph:

"(5) Coordination with section 1254.—This subsection shall not apply to any disposition to which section 1254 applies."

(c) Effective Dates.—

(1) In general.—The amendments made by this section shall apply to any disposition of property which is placed in service by the taxpayer after December 31, 1986.

(2) Exception for binding contracts.—The amendments made by this section shall not apply to any disposition of property placed in service after December 31, 1986, if such property was acquired pursuant to a written contract which was entered into before September 26, 1985, and which was binding at all times thereafter.

Subtitle C—Other Provisions

SEC. 421. EXTENSION OF ENERGY INVESTMENT CREDIT FOR SOLAR, GEOTHERMAL, OCEAN THERMAL, AND BIOMASS PROPERTY.

(a) In General.—The table contained in subparagraph (A) of section 46(b)(2) (relating to energy percentage) is amended by adding at the end thereof the following new items:

) Solar energy property.—Property cribed in section 48(l)(4) (other than nd energy property).	*A. 15 percent B. 12 percent C. 10 percent*	*Jan. 1, 1986 Jan. 1, 1987 Jan. 1, 1988*	*Dec. 31, 1986. Dec. 31, 1987. Dec. 31, 1988.*
Geothermal property.—Property de- ibed in section 48(l)(3)(A)(viii).	*A. 15 percent B. 10 percent*	*Jan. 1, 1986 Jan. 1, 1987*	*Dec. 31, 1986. Dec. 31, 1988.*
Ocean thermal property.—Property scribed in section 48(l)(3)(A)(ix).	*15 percent*	*Jan. 1, 1986*	*Dec. 31, 1988.*
Biomass property.—Property de- ribed in section 48(l)(15).	*A. 15 percent B. 10 percent*	*Jan. 1, 1986 Jan. 1, 1987*	*Dec. 31, 1986. Dec. 31, 1987."*

b) Treatment of Certain Transitional Rule Property.—ragraph (2) of section 46(b) is amended by adding at the end ereof the following new subparagraph:

"(E) Certain rules made applicable.—Rules similar to the rules of subsections (c) and (d) of section 49 shall apply to any credit allowable by reason of subparagraph (C) or (D)."

c) Effective Date.—The amendments made by this section shall ply to periods beginning after December 31, 1985, under rules nilar to rules under section 48(m) of the Internal Revenue Code of 86.

C. 422. PROVISIONS RELATING TO EXCISE TAX ON FUELS.

(a) Reduction in Excise Tax Exemption for Qualified Metha- ol and Ethanol Fuels.—

(1) In general.—Subparagraph (A) of section 4041(b)(2) (relating to exemption for qualified ethanol and methanol fuels) is amended to read as follows:

"(A) In general.—In the case of any qualified methanol or ethanol fuel, subsection (a)(2) shall be applied by substituting '3 cents' for '9 cents'.".

(2) Conforming amendment.—The heading for section 4041(b) is amended by striking out "Exemption" the second place it appears and inserting in lieu thereof "Reduction in Tax".

(3) Effective date.—The amendments made by this subsection shall take effect on January 1, 1987.

(b) Extension of Reduction in Tax for Fuel Used by Taxi- cabs.—Paragraph (3) of section 6427(e) (relating to termination) is amended by striking out "September 30, 1985" and inserting in lieu thereof "September 30, 1988".

SEC. 423. ETHYL ALCOHOL AND MIXTURES THEREOF FOR FUEL USE.

(a) In General.—Except as provided in subsection (b), no ethyl al- cohol or a mixture thereof may be considered—

(1) for purposes of general headnote 3(a) of the Tariff Schedules of the United States, to be—

(A) the growth or product of an insular possession of the United States,

(B) manufactured or produced in an insular possession from materials which are the growth, product, or manufacture of any such possession, or

(C) otherwise eligible for exemption from duty under such headnote as the growth or product of an insular possession; or

(2) for purposes of section 213 of the Caribbean Basin Economic Recovery Act, to be—

(A) an article that is wholly the growth, product, or manufacture of a beneficiary country,

(B) a new or different article of commerce which has been grown, produced, or manufactured in a beneficiary country,

(C) a material produced in a beneficiary country, or

(D) otherwise eligible for duty-free treatment under such Act as the growth, product, or manufacture of a beneficiary country;

unless the ethyl alcohol or mixture thereof is an indigenous product of that insular possession or beneficiary country.

(b) Exception.—

(1) Subject to the limitation in paragraph (2), subsection (a) shall not apply to ethyl alcohol that is imported into the United States during calendar years 1987 and 1988 and produced in—

(A) an azeotropic distillation facility located in an insular possession of the United States or a beneficiary country, if that facility was established before, and in operation on, January 1, 1986, or

(B) an azeotropic distillation facility—

(i) at least 50 percent of the total value of the equipment and components of which were—

(I) produced in the United States, and

(II) owned by a corporation at least 50 percent of the total value of the outstanding shares of stock of which were owned by a United States person (or persons) on or before January 1, 1986, and

(ii) substantially all of the equipment and components of which were, on or before January 1, 1986—

(I) located in the United States under the possession or control of such corporation,

(II) ready for shipment to, and installation in, a beneficiary country, and

(iii) which—

(I) has on the date of enactment of this Act, or

(II) will have at the time such facility is placed in service (based on estimates made before the date of enactment of this Act),

a stated capacity to produce not more than 42,000,000 gallons of such product per year.

(2) The exception provided under paragraph (1) shall cease to apply during each of calendar years 1987 and 1988 to ethyl alcohol produced in a facility described in subparagraph (A) or (B) of paragraph (1) after 20,000,000 gallons of ethyl alcohol produced in that facility are entered into the United States during that year.

(c) Definitions.—For purposes of this section—

(1) The term "ethyl alcohol or a mixture thereof" means (except for purposes of subsection (e)) ethyl alcohol or any mix-

ture thereof described in item 901.50 of the Appendix to the Tariff Schedules of the United States.

(2) Ethyl alcohol or a mixture thereof may be treated as being an indigenous product of an insular possession or beneficiary country only if the ethyl alcohol or a mixture thereof—

(A) has been both dehydrated and produced by a process of full-scale fermentation within that insular possession or beneficiary country; or

(B) has been dehydrated within that insular possession or beneficiary country from hydrous ethyl alcohol that includes hydrous ethyl alcohol which is wholly the product or manufacture of any insular possession or beneficiary country and which has a value not less than—

(i) 30 percent of the value of the ethyl alcohol or mixture, if entered during calendar year 1987, except that this clause shall not apply to any ethyl alcohol or mixture which has been dehydrated in the United States Virgin Islands by a facility with respect to which—

(I) the owner has entered into a binding contract for the engineering and design of full-scale fermentation capacity, and

(II) authorization for operation of a full-scale fermentation facility has been granted by the Island authorities before May 1, 1986,

(ii) 60 percent of the value of the ethyl alcohol or mixture, if entered during calendar year 1988, and

(iii) 75 percent of the value of the ethyl alcohol or mixture, if entered after December 31, 1988.

(3) The term "beneficiary country" has the meaning given to such term under section 212 of the Caribbean Basin Economic Recovery Act (19 U.S.C. 2702).

(4) The term "United States person" has the meaning given to such term by section 7701(a)(3) of the Internal Revenue Code of 1986.

(5) The term "entered" means entered, or withdrawn from warehouse, for consumption in the customs territory of the United States.

(d) AMENDMENT TO APPENDIX TO SCHEDULES.—The item designation for item 901.50 of the Appendix to the Tariff Schedules of the United States is amended to read as follows: "Ethyl alcohol (provided for in item 427.88, part 2D, schedule 4) or any mixture containing such ethyl alcohol (provided for in part 1, 2 or 10, schedule 4) if such ethyl alcohol or mixture is to be used as fuel or in producing a mixture of gasoline and alcohol, a mixture of a special fuel and alcohol, or any other mixture to be used as fuel (including motor fuel provided for in item 475.25), or is suitable for any such uses."

(e) DRAWBACKS.—

(1) For purposes of subsections (b) and (j)(2) of section 313 of the Tariff Act of 1930 (19 U.S.C. 1313), as amended by section 1888(2) of this Act, any ethyl alcohol (provided for in item 427.88 of the Tariff Schedules of the United States) or mixture containing such ethyl alcohol (provided for in part 1, 2, or 10 of schedule 4 of such Schedules) which is subject to the additional duty imposed by item 901.50 of the Appendix to such Schedules

may be treated as being fungible with, or of being of the same kind and quality as, any other imported ethyl alcohol (provided for in item 427.88 of such Schedules) or mixture containing such ethyl alcohol (provided for in part 1, 2, or 10 of schedule 4 of such Schedules) only if such other imported ethyl alcohol or mixture thereof is also subject to such additional duty.

(2) Paragraph (1) shall not apply with respect to ethyl alcohol (provided for in item 427.88 of the Tariff Schedules of the United States) or mixture containing such ethly alcohol (provided for in part 1, 2, or 10 of schedule 4 of such Schedules) that is exempt from the additional duty imposed by item 901.50 of the Appendix to such Schedules by reason of—

(A) subsection (b), or

(B) any agreement entered into under section 102 (b) of the Trade Act of 1974.

(f) CONFORMING AMENDMENTS.—

(1) General headnote 3(a)(i) of the Tariff Schedules of the United States is amended by inserting "and except as provided in section 423 of the Tax Reform Act of 1986," after "part 7 of schedule 7,".

(2) Section 213(a)(1) of the Caribbean Basin Economic Recovery Act (19 U.S.C. 2703(a)(1)) is amended by inserting "and subject to section 423 of the Tax Reform Act of 1986," after "Unless otherwise excluded from eligibility by this title,".

(3) The headnotes to subpart A of part 1 of the Appendix to the Tariff Schedules of the United States are amended by adding at the end thereof the following:

"2. For purposes of item 901.50, the phrase 'is suitable for any such uses' does not include ethyl alcohol (provided for in item 427.88, part 2D, schedule 4) that is certified by the importer of record to the satisfaction of the Commissioner of Customs (hereinafter in this headnote referred to as the 'Commissioner') to be ethyl alcohol or a mixture containing such ethyl alcohol imported for uses other than liquid motor fuel use or use in producing liquid motor fuel related mixtures. If the importer of record certifies nonliquid motor fuel use for purposes of establishing actual use or suitability under item 901.50, the Commissioner shall not liquidate the entry of ethyl alcohol until he is satisfied that the ethyl alcohol has in fact not been used for liquid motor fuel use or use in producing liquid motor fuel related mixtures. If he is not satisfied within a reasonable period of time not less than 18 months from the date of entry, then the duties provided for in item 901.50 shall be payable retroactive to the date of entry. Such duties shall also become payable, retroactive to the date of entry, immediately upon the diversion to liquid motor fuel use of any ethyl alcohol or ethyl alcohol mixture certified upon entry as having been imported for non-liquid motor fuel use."

(g) EFFECTIVE PERIOD.—

(1) The provisions of, and the amendments made by, this section (other than subsection (e)) shall apply to articles entered—

(A) after December 31, 1986, and

(B) before the expiration of the effective period of item 901.50 of the Appendix to the Tariff Schedules of the United States.

(2) The provisions of subsection (e) shall take effect on the date of the enactment of this Act.

TITLE V—TAX SHELTER LIMITATIONS; INTEREST LIMITATIONS

Subtitle A—Limitations On Tax Shelters

SEC. 501. LIMITATIONS ON LOSSES AND CREDITS FROM PASSIVE ACTIVITIES.

(a) GENERAL RULE.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deductions taken) is amended by adding at the end thereof the following new section:

"SEC. 469. PASSIVE ACTIVITY LOSSES AND CREDITS LIMITED.

"(a) DISALLOWANCE.—

"(1) IN GENERAL.—If for any taxable year the taxpayer is described in paragraph (2), neither—

"(A) the passive activity loss, nor

"(B) the passive activity credit,

for the taxable year shall be allowed.

"(2) PERSONS DESCRIBED.—The following are described in this paragraph:

"(A) any individual, estate, or trust,

"(B) any closely held C corporation, and

"(C) any personal service corporation.

"(b) DISALLOWED LOSS OR CREDIT CARRIED TO NEXT YEAR.—Except as otherwise provided in this section, any loss or credit from an activity which is disallowed under subsection (a) shall be treated as a deduction or credit allocable to such activity in the next taxable year.

"(c) PASSIVE ACTIVITY DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'passive activity' means any activity—

"(A) which involves the conduct of any trade or business, and

"(B) in which the taxpayer does not materially participate.

"(2) PASSIVE ACTIVITY INCLUDES ANY RENTAL ACTIVITY.—The term 'passive activity' includes any rental activity.

"(3) WORKING INTERESTS IN OIL AND GAS PROPERTY.—

"(A) IN GENERAL.—The term 'passive activity' shall not include any working interest in any oil or gas property which the taxpayer holds directly or through an entity which does not limit the liability of the taxpayer with respect to such interest.

"(B) INCOME IN SUBSEQUENT YEARS.—If any taxpayer has any loss for any taxable year from a working interest in any oil or gas property which is treated as a loss which is not from a passive activity, then any net income from such property (or any property the basis of which is determined in whole or in part by reference to the basis of such property) for any succeeding taxable year shall be treated as income of the taxpayer which is not from a passive activity.

"(4) MATERIAL PARTICIPATION NOT REQUIRED FOR PARAGRAPHS (2) AND (3).—Paragraphs (2) and (3) shall be applied without regard to whether or not the taxpayer materially participates in the activity.

"(5) TRADE OR BUSINESS INCLUDES RESEARCH AND EXPERIMENTATION ACTIVITY.—For purposes of paragraph (1)(A), the term 'trade or business' includes any activity involving research or experimentation (within the meaning of section 174).

"(6) ACTIVITY IN CONNECTION WITH TRADE OR BUSINESS OR PRODUCTION OF INCOME.—To the extent provided in regulations, for purposes of paragraph (1)(A), the term 'trade or business' includes—

"(A) any activity in connection with a trade or business, or

"(B) any activity with respect to which expenses are allowable as a deduction under section 212.

"(d) PASSIVE ACTIVITY LOSS AND CREDIT DEFINED.—For purposes of this section—

"(1) PASSIVE ACTIVITY LOSS.—The term 'passive activity loss' means the amount (if any) by which—

"(A) the aggregate losses from all passive activities for the taxable year, exceed

"(B) the aggregate income from all passive activities for such year.

"(2) PASSIVE ACTIVITY CREDIT.—The term 'passive activity credit' means the amount (if any) by which—

"(A) the sum of the credits from all passive activities allowable for the taxable year under—

"(i) subpart D of part IV of subchapter A, or

"(ii) subpart B (other than section 27(a)) of such part IV, exceeds

"(B) the regular tax liability of the taxpayer for the taxable year allocable to all passive activities.

"(e) SPECIAL RULES FOR DETERMINING INCOME OR LOSS FROM A PASSIVE ACTIVITY.—For purposes of this section—

"(1) CERTAIN INCOME NOT TREATED AS INCOME FROM PASSIVE ACTIVITY.—In determining the income or loss from any activity—

"(A) IN GENERAL.—There shall not be taken into account—

"(i) any—

"(I) gross income from interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business,

"(II) expenses (other than interest) which are clearly and directly allocable to such gross income, and

"(III) interest expense properly allocable to such gross income, and

"(ii) gain or loss attributable to the disposition of property—

"(I) producing income of a type described in clause (i), or

"(II) held for investment.

For purposes of clause (ii), any interest in a passive activity shall not be treated as property held for investment.

"(B) RETURN ON WORKING CAPITAL.—For purposes of subparagraph (A), any income, gain, or loss which is attributable to an investment of working capital shall be treated as not derived in the ordinary course of a trade or business.

"(2) PASSIVE LOSSES OF CERTAIN CLOSELY HELD CORPORATIONS MAY OFFSET ACTIVE INCOME.—

"(A) IN GENERAL.—If a closely held C corporation (other than a personal service corporation) has net active income for any taxable year, the passive activity loss of such taxpayer for such taxable year (determined without regard to this paragraph)—

"(i) shall be allowable as a deduction against net active income, and

"(ii) shall not be taken into account under subsection (a) to the extent so allowable as a deduction.

A similar rule shall apply in the case of any passive activity credit of the taxpayer.

"(B) NET ACTIVE INCOME.—For purposes of this paragraph, the term 'net active income' means the taxable income of the taxpayer for the taxable year determined without regard to—

"(i) any income or loss from a passive activity, and

"(ii) any item of gross income, expense, gain, or loss described in paragraph (1)(A).

"(3) COMPENSATION FOR PERSONAL SERVICES.—Earned income (within the meaning of section 911(d)(2)(A)) shall not be taken into account in computing the income or loss from a passive activity for any taxable year.

"(4) DIVIDENDS REDUCED BY DIVIDENDS RECEIVED DEDUCTION.—For purposes of paragraphs (1) and (2), income from dividends shall be reduced by the amount of any dividends received deduction under section 243, 244, or 245.

"(f) TREATMENT OF FORMER PASSIVE ACTIVITIES.—For purposes of this section—

"(1) IN GENERAL.—If an activity is a former passive activity for any taxable year—

"(A) any unused deduction allocable to such activity under subsection (b) shall be offset against the income from such activity for the taxable year,

"(B) any unused credit allocable to such activity under subsection (b) shall be offset against the regular tax liability (computed after the application of paragraph (1)) allocable to such activity for the taxable year, and

"(C) any such deduction or credit remaining after the application of subparagraphs (A) and (B) shall continue to be treated as arising from a passive activity.

"(2) CHANGE IN STATUS OF CLOSELY HELD C CORPORATION OR PERSONAL SERVICE CORPORATION.—If a taxpayer ceases for any taxable year to be a closely held C corporation or personal service corporation, this section shall continue to apply to losses and credits to which this section applied for any preceding taxable year in the same manner as if such taxpayer continued to

be a closely held C corporation or personal service corporation, whichever is applicable.

"(3) Former passive activity.—The term 'former passive activity' means any activity which, with respect to the taxpayer—

"(A) is not a passive activity for the taxable year, but

"(B) was a passive activity for any prior taxable year.

"(g) Dispositions of Entire Interest in Passive Activity.—If during the taxable year a taxpayer disposes of his entire interest in any passive activity (or former passive activity), the following rules shall apply:

"(1) Fully taxable transaction.—

"(A) In general.—If all gain or loss realized on such disposition is recognized, any loss from such activity which has not previously been allowed as a deduction (and in the case of a passive activity for the taxable year, any loss realized on such disposition) shall not be treated as a passive activity loss and shall be allowable as a deduction against income in the following order:

"(i) Income or gain from the passive activity for the taxable year (including any gain recognized on the disposition).

"(ii) Net income or gain for the taxable year from all passive activities.

"(iii) Any other income or gain.

"(B) Subparagraph (A) not to apply to disposition involving related party.—If the taxpayer and the person acquiring the interest bear a relationship to each other described in section 267(b) or section 707(b)(1), then subparagraph (A) shall not apply to any loss of the taxpayer until the taxable year in which such interest is acquired (in a transaction described in subparagraph (A)) by another person who does not bear such a relationship to the taxpayer.

"(C) Coordination with section 1211.—In the case of any loss realized on the disposition of an interest in a passive activity, section 1211 shall be applied before subparagraph (A) is applied.

"(2) Disposition by death.—If an interest in the activity is transferred by reason of the death of the taxpayer—

"(A) paragraph (1) shall apply to such losses to the extent such losses are greater than the excess (if any) of—

"(i) the basis of such property in the hands of the transferee, over

"(ii) the adjusted basis of such property immediately before the death of the taxpayer, and

"(B) any losses to the extent of the excess described in subparagraph (A) shall not be allowed as a deduction for any taxable year.

"(3) Installment sale of entire interest.—In the case of an installment sale of an entire interest in an activity to which section 453 applies, paragraph (1) shall apply to the portion of such losses for each taxable year which bears the same ratio to all such losses as the gain recognized on such sale during such

taxable year bears to the gross profit from such sale realized (or to be realized) when payment is completed.

"(h) Material Participation Defined.—For purposes of this section—

"(1) In general.—A taxpayer shall be treated as materially participating in an activity only if the taxpayer is involved in the operations of the activity on a basis which is—

"(A) regular,

"(B) continuous, and

"(C) substantial.

"(2) Interests in limited partnerships.—Except as provided in regulations, no interest in a limited partnership as a limited partner shall be treated as an interest with respect to which a taxpayer materially participates.

"(3) Treatment of certain retired individuals and surviving spouses.—A taxpayer shall be treated as materially participating in any farming activity for a taxable year if paragraph (4) or (5) of section 2032A(b) would cause the requirements of section 2032A(b)(1)(C)(ii) to be met with respect to real property used in such activity if such taxpayer had died during the taxable year.

"(4) Certain closely held C corporations and personal service corporations.—A closely held C corporation or personal service corporation shall be treated as materially participating in an activity if—

"(A) 1 or more shareholders holding stock representing more than 50 percent (by value) of the outstanding stock of such corporation materially participate in such activity, or

"(B) in the case of a closely held C corporation (other than a personal service corporation), the requirements of section 465(c)(7)(C) (without regard to clause (iv)) are met with respect to such activity.

"(5) Participation by spouse.—In determining whether a taxpayer materially participates, the participation of the spouse of the taxpayer shall be taken into account.

"(i) $25,000 Offset for Rental Real Estate Activities.—

"(1) In general.—In the case of any natural person, subsection (a) shall not apply to that portion of the passive activity loss or the deduction equivalent (within the meaning of subsection (j)(5)) of the passive activity credit for any taxable year which is attributable to all rental real estate activities with respect to which such individual actively participated in the taxable year in which such portion of such loss or credit arose.

"(2) Dollar limitation.—The aggregate amount to which paragraph (1) applies for any taxable year shall not exceed $25,000.

"(3) Phase-out of exemption.—

"(A) In general.—In the case of any taxpayer, the $25,000 amount under paragraph (2) shall be reduced (but not below zero) by 50 percent of the amount by which the adjusted gross income of the taxpayer for the taxable year exceeds $100,000.

"(B) Special phase-out of low-income housing and rehabilitation credits.—In the case of any portion of the

passive activity credit for any taxable year which is attributable to any credit to which paragraph (6)(B) applies, subparagraph (A) shall be applied by substituting '$200,000' for '$100,000'.

"(C) ORDERING RULE TO REFLECT SEPARATE PHASE-OUTS.—If subparagraph (B) applies for any taxable year, paragraph (1) shall be applied—

"(i) first to the passive activity loss,

"(ii) second to the portion of the passive activity credit to which subparagraph (B) does not apply, and

"(iii) then to the portion of such credit to which subparagraph (B) applies.

"(D) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined without regard to—

"(i) any amount includible in gross income under section 86,

"(ii) any amount allowable as a deduction under section 219, and

"(iii) any passive activity loss.

"(4) SPECIAL RULE FOR ESTATES.—

"(A) IN GENERAL.—In the case of taxable years of an estate ending less than 2 years after the date of the death of the decedent, this subsection shall apply to all rental real estate activities with respect to which such decedent actively participated before his death.

"(B) REDUCTION FOR SURVIVING SPOUSE'S EXEMPTION.—For purposes of subparagraph (A), the $25,000 amount under paragraph (2) shall be reduced by the amount of the exemption under paragraph (1) (without regard to paragraph (3)) allowable to the surviving spouse of the decedent for the taxable year ending with or within the taxable year of the estate.

"(5) MARRIED INDIVIDUALS FILING SEPARATELY.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of any married individual filing a separate return, this subsection shall be applied by substituting—

"(i) '$12,500' for '$25,000' each place it appears,

"(ii) '$50,000' for '$100,000' in paragraph (3)(A), and

"(iii) '$100,000' for '$200,000' in paragraph (3)(B).

"(B) TAXPAYERS NOT LIVING APART.— This subsection shall not apply to a taxpayer who—

"(i) is a married individual filing a separate return for any taxable year, and

"(ii) does not live apart from his spouse at all times during such taxable year.

"(6) ACTIVE PARTICIPATION.—

"(A) IN GENERAL.—An individual shall not be treated as actively participating with respect to any interest in any rental real estate activity for any period if, at any time during such period, such interest (including any interest of the spouse of the individual) is less than 10 percent (by value) of all interests in such activity.

"(B) No PARTICIPATION REQUIREMENT FOR LOW-INCOME HOUSING OR REHABILITATION CREDIT.—Paragraphs (1) and (4)(A) shall be applied without regard to the active participation requirement in the case of—

"(i) any credit determined under section 42 for any taxable year, or

"(ii) any rehabilitation investment credit (within the meaning of section 48(o)).

"(C) INTEREST AS A LIMITED PARTNER.—No interest as a limited partner in a limited partnership shall be treated as an interest with respect to which the taxpayer actively participates.

"(D) PARTICIPATION BY SPOUSE.—In determining whether a taxpayer actively participates, the participation of the spouse of the taxpayer shall be taken into account.

"(j) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) CLOSELY HELD C CORPORATION.—The term 'closely held C corporation' means any C corporation described in section 465(a)(1)(B).

"(2) PERSONAL SERVICE CORPORATION.—The term 'personal service corporation' has the meaning given such term by section 269A(b)(1), except that section 269A(b)(2) shall be applied—

"(A) by substituting 'any' for 'more than 10 percent', and

"(B) by substituting 'any' for '50 percent or more in value' in section 318(a)(2)(C).

A corporation shall not be treated as a personal service corporation unless more than 10 percent of the stock (by value) in such corporation is held by employee-owners (within the meaning of section 269A(b)(2), as modified by the preceding sentence).

"(3) REGULAR TAX LIABILITY.—The term 'regular tax liability' has the meaning given such term by section 26(b).

"(4) ALLOCATION OF PASSIVE ACTIVITY LOSS AND CREDIT.—The passive activity loss and the passive activity credit (and the $25,000 amount under subsection (i)) shall be allocated to activities, and within activities, on a pro rata basis in such manner as the Secretary may prescribe.

"(5) DEDUCTION EQUIVALENT.—The deduction equivalent of credits from a passive activity for any taxable year is the amount which (if allowed as a deduction) would reduce the regular tax liability for such taxable year by an amount equal to such credits.

"(6) SPECIAL RULE FOR GIFTS.—In the case of a disposition of any interest in a passive activity by gift—

"(A) the basis of such interest immediately before the transfer shall be increased by the amount of any passive activity losses allocable to such interest, and

"(B) such losses shall not be allowable as a deduction for any taxable year.

"(7) QUALIFIED RESIDENCE INTEREST.—The passive activity loss of a taxpayer shall be computed without regard to qualified residence interest (within the meaning of section 163(h)(3)).

"(8) RENTAL ACTIVITY.—The term 'rental activity' means any activity where payments are principally for the use of tangible property.

"(9) ELECTION TO INCREASE BASIS OF PROPERTY BY AMOUNT OF DISALLOWED CREDIT.—For purposes of determining gain or loss from a disposition of any property to which subsection (g)(1) applies, the transferor may elect to increase the basis of such property immediately before the transfer by an amount equal to the portion of any unused credit allowable under this chapter which reduced the basis of such property for the taxable year in which such credit arose. If the taxpayer elects the application of this paragraph, such portion of the passive activity credit of such taxpayer shall not be allowed for any taxable year.

"(k) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out provisions of this section, including regulations—

"(1) which specify what constitutes an activity, material participation, or active participation for purposes of this section,

"(2) which provide that certain items of gross income will not be taken into account in determining income or loss from any activity (and the treatment of expenses allocable to such income),

"(3) requiring net income or gain from a limited partnership or other passive activity to be treated as not from a passive activity,

"(4) which provide for the determination of the allocation of interest expense for purposes of this section, and

"(5) which deal with changes in marital status and changes between joint returns and separate returns.

"(l) PHASE-IN OF DISALLOWANCE OF LOSSES AND CREDITS FOR INTERESTS HELD BEFORE DATE OF ENACTMENT.—

"(1) IN GENERAL.—In the case of any passive activity loss or credit for any taxable year beginning in calendar years 1987 through 1990 which—

"(A) is attributable to a pre-enactment interest, but

"(B) is not attributable to a carryforward to such taxable year of any loss or credit which was disallowed under this section for a preceding taxable year,

there shall be disallowed under subsection (a) only the applicable percentage of the amount which (but for this subsection) would have been disallowed under subsection (a) for such taxable year.

"(2) APPLICABLE PERCENTAGE.—For purposes of this subsection, the applicable percentage shall be determined in accordance with the following table:

"In the case of taxable years beginning in:	The applicable percentage is:
1987	35
1988	60
1989	80
1990	90.

"(3) PORTION OF LOSS OR CREDIT ATTRIBUTABLE TO PRE-ENACTMENT INTERESTS.—For purposes of this subsection—

"(A) In general.—The portion of the passive activity loss for any taxable year which is attributable to pre-enactment interests shall be equal to the lesser of—

"(i) the passive activity loss for such taxable year, or

"(ii) the passive activity loss for such taxable year determined by taking into account only pre-enactment interests.

For purposes of this subparagraph, the deduction equivalent (within the meaning of subsection (j)(5)) of a passive activity credit shall be taken into account.

"(B) Pre-enactment interest.—

"(i) In general.—The term 'pre-enactment interest' means any interest in a passive activity held by a taxpayer on the date of the enactment of the Tax Reform Act of 1986, and at all times thereafter.

"(ii) Binding contract exception.—For purposes of clause (i), any interest acquired after such date of enactment pursuant to a written binding contract in effect on such date, and at all times thereafter, shall be treated as held on such date.

"(iii) Interest in activities.—The term 'pre-enactment interest' shall not include an interest in a passive activity unless such activity was being conducted on such date of enactment. The preceding sentence shall not apply to an activity commencing after such date if—

"(I) the property used in such activity is acquired pursuant to a written binding contract in effect on August 16, 1986, and at all times thereafter, or

"(II) construction of property used in such activity began on or before August 16, 1986."

(b) Conforming Amendment.—The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 469. Passive activity losses and credits limited."

(c) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Special rule for carryovers.—The amendments made by this section shall not apply to any loss, deduction, or credit carried to a taxable year beginning after December 31, 1986, from a taxable year beginning before January 1, 1987.

(3) Special rule for low-income housing.—

(A) In general.—Except as provided in subparagraph (B), section 469(i)(6)(B)(i) of the Internal Revenue Code of 1986 (as added by this section) shall not apply to any property placed in service after December 31, 1989.

(B) Exception where at least 10 percent of costs incurred.—In the case of property placed in service after December 31, 1989, and before January 1, 1991, section 469(i)(6)(B)(i) of such Code shall apply to such property if at least 10 percent of the costs of such property were incurred before January 1, 1989.

SEC. 502. TRANSITIONAL RULE FOR LOW-INCOME HOUSING.

(a) General Rule.—Any loss sustained by a qualified investor with respect to an interest in a qualified low-income housing project for any taxable year in the relief period shall not be treated as a loss from a passive activity for purposes of section 469 of the Internal Revenue Code of 1986.

(b) Relief Period.—For purposes of subsection (a), the term "relief period" means the period beginning with the taxable year in which the investor made his initial investment in the qualified low-income housing project and ending with whichever of the following is the earliest—

(1) the 6th taxable year after the taxable year in which the investor made his initial investment,

(2) the 1st taxable year after the taxable year in which the investor is obligated to make his last investment, or

(3) the taxable year preceding the 1st taxable year for which such project ceased to be a qualified low-income housing project.

(c) Qualified Low-Income Housing Project.—For purposes of this section, the term "qualified low-income housing project" means any project if—

(1) such project meets the requirements of clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B) as of the date placed in service and for each taxable year thereafter which begins after 1986 and for which a passive loss may be allowable with respect to such project,

(2) the operator certifies to the Secretary of the Treasury or his delegate that such project met the requirements of paragraph (1) on the date of the enactment of this Act (or, if later, when placed in service) and annually thereafter,

(3) such project is constructed or acquired pursuant to a binding written contract entered into on or before August 16, 1986, and

(4) such project is placed in service before January 1, 1989.

(d) Qualified Investor.—For purposes of this section—

(1) In general.—The term "qualified investor" means any natural person who holds (directly or through 1 or more entities) an interest in a qualified low-income housing project—

(A) if—

(i) in the case of a project placed in service before August 16, 1986, such person held an interest in such project on August 16, 1986, and the taxpayer made his initial investment after December 31, 1983, or

(ii) in the case of a project not described in subparagraph (A), such investor held an interest in such project on December 31, 1986, and

(B) if such investor is required to make payments after December 31, 1986, of 50 percent or more of the total original obligated investment for such interest.

For purposes of subparagraph (A), a person shall be treated as holding an interest on August 16, 1986, or December 31, 1986, if on such date such person had a binding contract to acquire such interest.

(2) TREATMENT OF ESTATES.—The estate of a decedent shall succeed to the treatment under this section of the decedent but only with respect to the 1st 2 taxable years of such estate ending after the date of the decedent's death.

(d) SPECIAL RULES.—

(1) WHERE MORE THAN 1 BUILDING IN PROJECT.—If there is more than 1 building in any project, the determination of when such project is placed in service shall be based on when the 1st building in such project is placed in service.

(2) ONLY CASH AND OTHER PROPERTY TAKEN INTO ACCOUNT.—In determining the amount any person invests in (or is obligated to invest in) any interest, only cash and other property shall be taken into account.

(3) COORDINATION WITH CREDIT.—No low-income housing credit shall be determined under section 42 of the Internal Revenue Code of 1986 with respect to any project with respect to which any person has been allowed any benefit under this section.

SEC. 503. EXTENSION OF AT RISK LIMITATIONS TO REAL PROPERTY.

(a) IN GENERAL.—Paragraph (3) of section 465(c) (relating to activities to which section applies) is amended by striking out subparagraph (D) and by redesignating subparagraph (E) as subparagraph (D).

(b) QUALIFIED NONRECOURSE FINANCING TREATED AS AN AMOUNT AT RISK.—Section 465(b) (relating to amounts considered at risk) is amended by adding at the end thereof the following new paragraph:

"(6) QUALIFIED NONRECOURSE FINANCING TREATED AS AMOUNT AT RISK.—For purposes of this section—

"(A) IN GENERAL.—Notwithstanding any other provision of this subsection, in the case of an activity of holding real property, a taxpayer shall be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing which is secured by real property used in such activity.

"(B) QUALIFIED NONRECOURSE FINANCING.—For purposes of this paragraph, the term 'qualified nonrecourse financing' means any financing—

"(i) which is borrowed by the taxpayer with respect to the activity of holding real property,

"(ii) which is borrowed by the taxpayer from a qualified person or represents a loan from any Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government,

"(iii) except to the extent provided in regulations, with respect to which no person is personally liable for repayment, and

"(iv) which is not convertible debt.

"(C) SPECIAL RULE FOR PARTNERSHIPS.—In the case of a partnership, a partner's share of any qualified nonrecourse financing of such partnership shall be determined on the basis of the partner's share of liabilities of such partnership incurred in connection with such financing (within the meaning of section 752).

"(D) Qualified person defined.—For purposes of this paragraph—

"(i) In general.—The term 'qualified person' has the meaning given such term by section 46(c)(8)(D)(iv).

"(ii) Certain commercially reasonable financing from related persons.—For purposes of clause (i), section 46(c)(8)(D)(iv) shall be applied without regard to subclause (I) thereof (relating to financing from related persons) if the financing from the related person is commercially reasonable and on substantially the same terms as loans involving unrelated persons.

"(E) Activity of holding real property.—For purposes of this paragraph—

"(i) Incidental personal property and services.—The activity of holding real property includes the holding of personal property and the providing of services which are incidental to making real property available as living accommodations.

"(ii) Mineral property.—The activity of holding real property shall not include the holding of mineral property."

(c) Effective Dates.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to losses incurred after December 31, 1986, with respect to property placed in service by the taxpayer after December 31, 1986.

(2) Special rule for losses of S corporation, partnership, or pass-thru entity.—In the case of an interest in an S corporation, a partnership, or other pass-thru entity acquired after December 31, 1986, the amendments made by this section shall apply to losses after December 31, 1986, which are attributable to property placed in service by the S corporation, partnership, or pass-thru entity on, before, or after January 1, 1986.

(3) Special rule for athletic stadium.—The amendments made by this section shall not apply to any losses incurred by a taxpayer with respect to the holding of a multi-use athletic stadium in Pittsburgh, Pennsylvania, which the taxpayer acquired in a sale for which a letter of understanding was entered into before April 16, 1986.

Subtitle B—Interest Expense

SEC. 511. LIMITATIONS ON DEDUCTION FOR NONBUSINESS INTEREST.

(a) Limitation on Investment Interest.—Subsection (d) of section 163 (relating to limitation on interest on investment indebtedness) is amended to read as follows:

"(d) Limitation on Investment Interest.—

"(1) In general.—In the case of a taxpayer other than a corporation, the amount allowed as a deduction under this chapter for investment interest for any taxable year shall not exceed the net investment income of the taxpayer for the taxable year.

"(2) Carryforward of disallowed interest.—The amount not allowed as a deduction for any taxable year by reason of

paragraph (1) shall be treated as investment interest paid or accrued by the taxpayer in the succeeding taxable year.

"(3) Investment interest.—For purposes of this subsection—

"(A) In general.—The term 'investment interest' means any interest allowable as a deduction under this chapter (determined without regard to paragraph (1)) which is paid or accrued on indebtedness incurred or continued to purchase or carry property held for investment.

"(B) Exceptions.—The term 'investment interest' shall not include—

"(i) any qualified residence interest (as defined in subsection (h)(3)), or

"(ii) any interest which is taken into account under section 469 in computing income or loss from a passive activity of the taxpayer.

"(C) Personal property used in short sale.—For purposes of this paragraph, the term 'interest' includes any amount allowable as a deduction in connection with personal property used in a short sale.

"(4) Net investment income.—For purposes of this subsection—

"(A) In general.—The term 'net investment income' means the excess of—

"(i) investment income, over

"(ii) investment expenses.

"(B) Investment income.—The term 'investment income' means the sum of—

"(i) gross income (other than gain described in clause (ii)) from property held for investment, and

"(ii) any net gain attributable to the disposition of property held for investment,

but only to the extent such amounts are not derived from the conduct of a trade or business.

"(C) Investment expenses.—The term 'investment expenses' means the deductions allowed under this chapter (other than for interest) which are directly connected with the production of investment income.

"(D) Income and expenses from passive activities.—Investment income and investment expenses shall not include any income or expenses taken into account under section 469 in computing income or loss from a passive activity.

"(E) Reduction in investment income during phase-in of passive loss rules.—Investment income of the taxpayer for any taxable year shall be reduced by the amount of the passive activity loss to which section 469(a) does not apply for such taxable year by reason of section 469(l). The preceding sentence shall not apply to any portion of such passive activity loss which is attributable to a rental real estate activity with respect to which the taxpayer actively participates (within the meaning of section 469(i)(6)) during such taxable year.

"(5) Property held for investment.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'property held for investment' shall include—

"(i) any property which produces income of a type described in section 469(e)(1), and

"(ii) any interest held by a taxpayer in an activity involving the conduct of a trade or business—

"(I) which is not a passive activity, and

"(II) with respect to which the taxpayer does not materially participate.

"(B) INVESTMENT EXPENSES.—In the case of property described in subparagraph (A)(i), expenses shall be allocated to such property in the same manner as under section 469.

"(C) TERMS.—For purposes of this paragraph, the terms 'activity', 'passive activity', and 'materially participate' have the meanings given such terms by section 469.

"(6) PHASE-IN OF DISALLOWANCE.—In the case of any taxable year beginning in calendar years 1987 through 1990—

"(A) IN GENERAL.—The amount of interest disallowed under this subsection for any such taxable year shall be equal to the sum of—

"(i) the applicable percentage of the amount which (without regard to this paragraph) is not allowed as a deduction under this subsection for the taxable year to the extent such amount does not exceed the ceiling amount,

"(ii) the amount which (without regard to this paragraph) is not allowed as a deduction under this subsection in excess of the ceiling amount, plus

"(iii) the amount of any carryforward to such taxable year under paragraph (2) with respect to which a deduction was disallowed under this subsection for a preceding taxable year.

For purposes of this subparagraph, the amount under clause (i) or (ii) shall be computed without regard to the amount described in clause (iii).

"(B) APPLICABLE PERCENTAGE.—For purposes of this paragraph, the applicable percentage shall be determined in accordance with the following table:

"In the case of taxable years beginning in:	The applicable percentage is:
1987	35
1988	60
1989	80
1990	90.

"(C) CEILING AMOUNT.—For purposes of this paragraph, the term 'ceiling amount' means—

"(i) $10,000 in the case of a taxpayer not described in clause (ii) or (iii),

"(ii) $5,000 in the case of a married individual filing a separate return, and

"(iii) zero in the case of a trust.

(b) DISALLOWANCE OF DEDUCTION FOR PERSONAL INTEREST OF INDIVIDUALS.—Section 163 (relating to deduction for interest) is

amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) Disallowance of Deduction for Personal Interest.—

"(1) In general.—In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year.

"(2) Personal interest.—For purposes of this subsection, the term 'personal interest' means any interest allowable as a deduction under this chapter other than—

"(A) interest paid or accrued on indebtedness incurred or continued in connection with the conduct of a trade or business (other than the trade or business of performing services as an employee),

"(B) any investment interest (within the meaning of subsection (d)),

"(C) any interest which is taken into account under section 469 in computing income or loss from a passive activity of the taxpayer,

"(D) any qualified residence interest (within the meaning of paragraph (3)), and

"(E) any interest payable under section 6601 on any unpaid portion of the tax imposed by section 2001 for the period during which an extension of time for payment of such tax is in effect under section 6163 or 6166.

"(3) Qualified residence interest.—For purposes of this subsection—

"(A) In general.—The term 'qualified residence interest' means interest which is paid or accrued during the taxable year on indebtedness which is secured by any property which (at the time such interest is paid or accrued) is a qualified residence of the taxpayer.

"(B) Limitation on amount of interest.—The term 'qualified residence interest' shall not include any interest paid or accrued on indebtedness secured by any qualified residence which is allocable to that portion of the principal amount of such indebtedness which, when added to the outstanding aggregate principal amount of all other indebtedness previously incurred and secured by such qualified residence, exceeds the lesser of—

"(i) the fair market value of such qualified residence, or

"(ii) the sum of—

"(I) the taxpayer's basis in such qualified residence (adjusted only by the cost of any improvements to such residence), plus

"(II) the aggregate amount of qualified indebtedness of the taxpayer with respect to such qualified residence.

"(C) Cost not less than balance of indebtedness incurred on or before August 16, 1986.—The amount under subparagraph (B)(ii)(I) at any time after August 16, 1986, shall not be less than the outstanding aggregate principal amount (as of such time) of indebtedness which was incurred

on or before August 16, 1986, and which was secured by the qualified residence on August 16, 1986.

"(D) TIME FOR DETERMINATION.—Except as provided in regulations, any determination under subparagraph (B) shall be made as of the time the indebtedness is incurred.

"(4) QUALIFIED INDEBTEDNESS.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified indebtedness' means indebtedness secured by a qualified residence of the taxpayer which is incurred after August 16, 1986, to pay for—

"(i) qualified medical expenses, or

"(ii) qualified educational expenses,

which are paid or incurred within a reasonable period of time before or after such indebtedness is incurred.

"(B) QUALIFIED MEDICAL EXPENSES.—For purposes of this paragraph, the term 'qualified medical expenses' means amounts, not compensated for by insurance or otherwise, incurred for medical care (within the meaning of subparagraphs (A) and (B) of section 213(d)(1)) for the taxpayer, his spouse, or a dependent.

"(C) QUALIFIED EDUCATIONAL EXPENSES.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'qualified educational expenses' means qualified tuition and related expenses of the taxpayer, his spouse, or a dependent for attendance at an educational institution described in section 170(b)(1)(A)(ii).

"(ii) QUALIFIED TUITION AND RELATED EXPENSES.—The term 'qualified tuition and related expenses' has the meaning given such term by section 117(b), except that such term shall include any reasonable living expenses while away from home.

"(D) DEPENDENT.—For purposes of this paragraph, the term 'dependent' has the meaning given such term by section 152.

"(5) OTHER DEFINITIONS AND SPECIAL RULES.—

"(A) QUALIFIED RESIDENCE.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'qualified residence' means—

"(I) the principal residence (within the meaning of section 1034) of the taxpayer, and

"(II) 1 other residence of the taxpayer which is selected by the taxpayer for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence (within the meaning of section 280A(d)(1)).

"(ii) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If a married couple does not file a joint return for the taxable year—

"(I) such couple shall be treated as 1 taxpayer for purposes of clause (i), and

"(II) each individual shall be entitled to take into account 1 residence unless both individuals consent in writing to 1 individual taking into account the principal residence and 1 other residence.

"(iii) Residence not used or rented.—For purposes of clause (i)(II), notwithstanding section 280A(d)(1), if the taxpayer does not rent or use a dwelling unit at any time during a taxable year, such unit may be treated as a residence for such taxable year.

"(B) Special rule for cooperative housing corporations.—For purposes of this paragraph, any indebtedness secured by stock held by the taxpayer as a tenant-stockholder (as defined in section 216) in a cooperative housing corporation (as so defined) shall be treated as secured by the house or apartment which the taxpayer is entitled to occupy as such a tenant-stockholder. If stock described in the preceding sentence may not be used to secure indebtedness, indebtedness shall be treated as so secured if the taxpayer establishes to the satisfaction of the Secretary that such indebtedness was incurred to acquire such stock.

"(6) Phase-in of limitation.—In the case of any taxable year beginning in calendar years 1987 through 1990, the amount of interest with respect to which a deduction is disallowed under this subsection shall be equal to the applicable percentage (within the meaning of subsection (d)(6)(B)) of the amount which (but for this subsection) would have been so disallowed."

(d) Technical Amendments.—

(1) Clause (i) of section 7872(d)(1)(E) is amended by striking out "section 163(d)(3)" and inserting in lieu thereof "section 163(d)(4)".

(2)(A) Sections 467(c)(5) and 1255(b)(2) are each amended by striking out "section 163(d),".

(B) Section 703(b) is amended by striking out paragraph (3) and by redesignating paragraphs (4) and (5) as paragraphs (3) and (4), respectively.

(C) Section 1363(c)(2) is amended by striking out subparagraph (A) and by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(e) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

TITLE VI—CORPORATE PROVISIONS

Subtitle A—Corporate Rate Reductions

SEC. 601. CORPORATE RATE REDUCTIONS.

(a) General Rule.—Subsection (b) of section 11 is amended to read as follows:

"(b) Amount of Tax.—The amount of the tax imposed by subsection (a) shall be the sum of—

"(1) 15 percent of so much of the taxable income as does not exceed $50,000,

"(2) 25 percent of so much of the taxable income as exceeds $50,000 but does not exceed $75,000, and

"(3) 34 percent of so much of the taxable income as exceeds $75,000.

In the case of a corporation which has taxable income in excess of $100,000 for any taxable year, the amount of tax determined under the preceding sentence for such taxable year shall be increased by the lesser of (A) 5 percent of such excess, or (B) $11,750."

(b) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to taxable years beginning on or after July 1, 1987.

(2) CROSS REFERENCE.—

For treatment of taxable years which include July 1, 1987, see section 15 of the Internal Revenue Code of 1986.

Subtitle B—Treatment of Stock and Stock Dividends

SEC. 611. REDUCTION IN DIVIDENDS RECEIVED DEDUCTION.

(a) GENERAL RULE.—The following provisions are each amended by striking out "85 percent" and inserting in lieu thereof "80 percent":

(1) Section 243(a)(1) (relating to dividends received by corporations).

(2) Sections 244 (a)(3) and (b)(2) (relating to dividends received on certain preferred stock).

(3) Section 246(b)(1) (relating to limitation on aggregate amount of deductions).

(4) Section 246A(a)(1) (relating to dividends received deduction reduced where portfolio stock is debt financed).

(5) Subparagraph (B) of section 805(a)(4) (relating to dividends received by insurance company).

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by subsection (a) shall apply to dividends received or accrued after December 31, 1986, in taxable years ending after such date.

(2) AMENDMENT RELATING TO LIMITATION ON DEDUCTIONS.—The amendment made by subsection (a) to section 246(b) of the Internal Revenue Code of 1986 shall apply to taxable years beginning after December 31, 1986.

SEC. 612. REPEAL OF PARTIAL EXCLUSION OF DIVIDENDS RECEIVED BY INDIVIDUALS.

(a) GENERAL RULE.—Section 116 (relating to partial exclusion of dividends received by individuals) is hereby repealed.

(b) TECHNICAL AMENDMENTS.—

(1) Subsection (g) of section 301 is amended by striking out paragraph (4).

(2)(A) Subsection (c) of section 584 is amended to read as follows:

"(c) Income of Participants in Fund.—Each participant in the common trust fund in computing its taxable income shall include, whether or not distributed and whether or not distributable—

"(1) as part of its gains and losses from sales or exchanges of capital assets held for not more than 6 months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for not more than 6 months,

"(2) as part of its gains and losses from sales or exchanges of capital assets held for more than 6 months, its proportionate share of the gains and losses of the common trust fund from sales or exchanges of capital assets held for more than 6 months, and

"(3) its proportionate share of the ordinary taxable income or the ordinary net loss of the common trust fund, computed as provided in subsection (d)."

(B) If the amendments made by section 1001 of the Tax Reform Act of 1984 cease to apply, effective with respect to property to which such amendments do not apply, subsection (c) of section 584 is amended by striking out "6 months" each place it appears and inserting in lieu thereof "1 year".

(3) Section 642 is amended by striking out subsection (j).

(4) Paragraph (7) of section 643(a) is hereby repealed.

(5) Paragraph (5) of section 702(a) is amended to read as follows:

"(5) dividends with respect to which there is a deduction under part VIII of subchapter B,".

(6) Section 854 is amended—

(A) by striking out "section 116 (relating to an exclusion for dividends received by individuals), and" in subsection (a),

(B) in subsection (b)—

(i) by striking out subparagraph (B) of paragraph (1) and redesignating subparagraph (C) as subparagraph (B),

(ii) by striking out "or (B)" in subparagraph (B) (as so redesignated),

(iii) by striking out "the exclusion under section 116 and" in paragraph (2), and

(iv) by amending subparagraph (B) of paragraph (3) to read as follows:

"(B)(i) The term 'aggregate dividends received' includes only dividends received from domestic corporations.

"(ii) For purposes of clause (i), the term 'dividend' shall not include any distribution from—

"(I) a corporation which, for the taxable year of the corporation in which the distribution is made, or for the next preceding taxable year of the corporation, is a corporation exempt from tax under section 501 (relating to certain charitable, etc., organizations) or section 521 (relating to farmers' cooperative associations), or

"(II) a real estate investment trust which, for the taxable year of the trust in which the dividend is paid,

qualifies under part II of subchapter M (section 856 and following).

"(iii) In determining the amount of any dividend for purposes of this subparagraph, a dividend received from a regulated investment company shall be subject to the limitations prescribed in this section."

(7) Subsection (c) of section 857 is amended by striking out "section 116 (relating to an exclusion for dividends received by individuals), and".

(8) The table of sections for part III of subchapter B of chapter 1 is amended by striking out the item relating to section 116.

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 613. NONDEDUCTIBILITY OF STOCK REDEMPTION EXPENSES.

(a) In General.—Section 162 (relating to trade or business expenses), is amended by redesignating subsection (l) as subsection (m) and inserting after subsection (k) the following new subsection:

"(l) Stock Redemption Expenses.—

"(1) In general.—Except as provided in paragraph (2), no deduction otherwise allowable shall be allowed under this chapter for any amount paid or incurred by a corporation in connection with the redemption of its stock.

"(2) Exceptions.—Paragraph (1) shall not apply to—

"(A) Certain specific deductions.—Any—

"(i) deduction allowable under section 163 (relating to interest), or

"(ii) deduction for dividends paid (within the meaning of section 561).

"(B) Stock of certain regulated investment companies.—Any amount paid or incurred in connection with the redemption of any stock in a regulated investment company which issues only stock which is redeemable upon the demand of the shareholder."

(b) Effective Date.—The amendments made by subsection (a) shall apply to any amount paid or incurred after February 28, 1986, in taxable years ending after such date.

SEC. 614. REDUCTION IN STOCK BASIS FOR NONTAXED PORTION OF EXTRAORDINARY DIVIDENDS.

(a) 2-Year Holding Requirement.—

(1) In general.—Section 1059(a) (relating to corporate shareholder's basis in stock reduced by nontaxed portion of extraordinary dividends) is amended to read as follows:

"(a) General Rule.—If any corporation receives any extraordinary dividend with respect to any share of stock and such corporation has not held such stock for more than 2 years before the dividend announcement date—

"(1) Reduction in basis.—The basis of such corporation in such stock shall be reduced (but not below zero) by the nontaxed portion of such dividends.

"(2) Recognition upon sale or disposition in certain cases.—In addition to any gain recognized under this chapter, there shall be treated as gain from the sale or exchange of any stock for the taxable year in which the sale or disposition of

such stock occurs an amount equal to the aggregate nontaxed portions of any extraordinary dividends with respect to such stock which did not reduce the basis of such stock by reason of the limitation on reducing basis below zero."

(2) Dividend announcement date.—Section 1059(d) (relating to special rules) is amended by adding at the end thereof the following new paragraph:

"(6) Dividend announcement date.—The term 'dividend announcement date' means, with respect to any dividend, the date on which the corporation declares, announces, or agrees to, the payment of such dividend, whichever is the earliest."

(3) Conforming Amendment.—Section 1059(d)(3) (relating to determination of holding period) is amended by striking out "1 year" and inserting in lieu thereof "2 years".

(b) Extraordinary Dividend May Be Determined by Reference to Fair Market Value.—Section 1059(c) (defining extraordinary dividend) is amended by adding at the end thereof the following new paragraph:

"(4) Fair market value determination.—If the taxpayer establishes to the satisfaction of the Secretary the fair market value of any share of stock as of the day before the ex-dividend date, the taxpayer may elect to apply paragraphs (1) and (3) by substituting such value for the taxpayer's adjusted basis."

(c) Time for Reduction in Basis.—

(1) In general.—Paragraph (1) of section 1059(d) (relating to time for reduction) is amended to read as follows:

"(1) Time for reduction.—

"(A) In general.—Except as provided in subparagraph (B), any reduction in basis under subsection (a)(1) shall occur immediately before any sale or disposition of the stock.

"(B) Special rule for computing extraordinary dividend.—In determining a taxpayer's adjusted basis for purposes of subsection (c)(1), any reduction in basis under subsection (a)(1) by reason of a prior distribution which was an extraordinary dividend shall be treated as occurring at the beginning of the ex-dividend date for such distribution."

(2) Conforming amendment.—Section 1059(c)(1) is amended by striking out "(determined without regard to this section)".

(d) No Extraordinary Dividend Where Stock Held During Entire Existence of Corporation.—Section 1059(d) (relating to special rules) is amended by adding at the end thereof the following new paragraph:

"(7) Exception where stock held during entire existence of corporation.—Subsection (a) shall not apply to any extraordinary dividend with respect to any share of stock of a corporation if—

"(A) such stock was held by the taxpayer during the entire period such corporation (and any precedessor corporation) was in existence,

"(B) except as provided in regulations, the only earnings and profits of such corporation were earnings and profits accumulated by such corporation (or any predecessor corporation) during such period, and

"(C) the application of this paragraph to such dividend is not inconsistent with the purposes of this section."

(e) Certain Liquidations and Redemptions Treated As Extraordinary Dividends; Qualifying Dividends Not Treated as Extraordinary Dividends; Special Rule for Preferred Dividends.—Section 1059 (relating to extraordinary dividends) is amended by redesignating subsection (e) as subsection (f) and by adding after subsection (d) the following new subsection:

"(e) Special Rules for Certain Distributions.—

"(1) Treatment of partial liquidations and non-pro rata redemptions.—Except as otherwise provided in regulations, in the case of any redemption of stock which is—

"(A) part of a partial liquidation (within the meaning of section 302(e)) of the redeeming corporation, or

"(B) not pro rata as to all shareholders,

any amount treated as a dividend under section 301 with respect to such redemption shall be treated as an extraordinary dividend for purposes of this section (without regard to the holding period of the stock).

"(2) Qualifying dividends.—Excpet as provided in regulations, the term 'extraordinary dividend' shall not include any qualifying dividend (within the meaning of section 243(b)(1)).

"(3) Qualified preferred dividends.—

"(A) In general.—A qualified preferred dividend shall be treated as an extraordinary dividend—

"(i) only if the actual rate of return of the taxpayer on the stock with respect to which such dividend was paid exceeds 15 percent, or

"(ii) if clause (i) does not apply, and the taxpayer disposes of such stock before the taxpayer has held such stock for more than 5 years, only to the extent the actual rate of return exceeds the stated rate of return.

"(B) Rate of return.—For purposes of subparagraph (A)—

"(i) Actual rate of return.—The actual rate of return shall be the rate of return for the period for which the taxpayer held the stock, determined—

"(I) by only taking into account dividends during such period, and

"(II) by using the lesser of the adjusted basis of the taxpayer in such stock or the liquidation preference of such stock.

"(ii) Stated rate of return.—The stated rate of return shall be the annual rate of the qualified preferred dividend payable with respect to any share of stock (expressed as a percentage of the amount described in subparagraph (B)(i)(II)).

"(C) Definitions and special rules.—For purposes of this paragraph—

"(i) Qualified preferred dividend.—The term 'qualified preferred dividend' means any dividend payable with respect to any share of stock which—

"(I) provides for fixed preferred dividends payable not less frequently than annually, and

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"(II) is not in arrears as to dividends at the time the taxpayer acquires the stock.

"(ii) HOLDING PERIOD.—In determining the holding period for purposes of subparagraph (A)(ii), subsection (d)(3) shall be applied by substituting '5 years' for '2 years'."

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to dividends declared after July 18, 1986, in taxable years ending after such date.

(2) AGGREGATION.—For purposes of section 1059(c)(3) of the Internal Revenue Code of 1986, dividends declared after July 18, 1986, shall not be aggregated with dividends declared on or before July 18, 1986.

(3) REDEMPTIONS.—Section 1059(e)(1) of the Internal Revenue Code of 1986 (as added by subsection (e)) shall apply to dividends declared after the date of the enactment of this Act, in taxable years ending after such date.

Subtitle C—Limitation on Net Operating Loss Carryforwards and Excess Credit Carryforwards

SEC. 621. LIMITATION ON NET OPERATING LOSS CARRYFORWARDS.

(a) IN GENERAL.—Section 382 (relating to special limitations on net operating loss carryovers) is amended to read as follows:

"SEC. 382. LIMITATION ON NET OPERATING LOSS CARRYFORWARDS AND CERTAIN BUILT-IN LOSSES FOLLOWING OWNERSHIP CHANGE.

"(a) GENERAL RULE.—The amount of the taxable income of any new loss corporation for any post-change year which may be offset by pre-change losses shall not exceed the section 382 limitation for such year.

"(b) SECTION 382 LIMITATION.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this section, the section 382 limitation for any post-change year is an amount equal to—

"(A) the value of the old loss corporation, multiplied by

"(B) the long-term tax-exempt rate.

"(2) CARRYFORWARD OF UNUSED LIMITATION.—If the section 382 limitation for any post-change year exceeds the taxable income of the new loss corporation for such year which was offset by pre-change losses, the section 382 limitation for the next post-change year shall be increased by the amount of such excess.

"(3) SPECIAL RULE FOR POST-CHANGE YEAR WHICH INCLUDES CHANGE DATE.—In the case of any post-change year which includes the change date—

"(A) LIMITATION DOES NOT APPLY TO TAXABLE INCOME BEFORE CHANGE.—Subsection (a) shall not apply to the portion of the taxable income for such year which is allocable to the period in such year on or before the change date. Except as provided in subsection (h)(5) and in regulations,

taxable income shall be allocated ratably to each day in the year.

"(B) LIMITATION FOR PERIOD AFTER CHANGE.—For purposes of applying the limitation of subsection (a) to the remainder of the taxable income for such year, the section 382 limitation shall be an amount which bears the same ratio to such limitation (determined without regard to this paragraph) as—

"(i) the number of days in such year after the change date, bears to

"(ii) the total number of days in such year.

"(c) CARRYFORWARDS DISALLOWED IF CONTINUITY OF BUSINESS REQUIREMENTS NOT MET.—

"(1) IN GENERAL.—Except as provided in paragraph (2), if the new loss corporation does not continue the business enterprise of the old loss corporation at all times during the 2-year period beginning on the change date, the section 382 limitation for any post-change year shall be zero.

"(2) EXCEPTION FOR CERTAIN GAINS.—The section 382 limitation for any post-change year shall not be less than the sum of—

"(A) any increase in such limitation under—

"(i) subsection (h)(1)(A) for recognized built-in gains for such year, and

"(ii) subsection (h)(1)(C) for gain recognized by reason of an election under section 338, plus

"(B) any increase in such limitation under subsection (b)(2) for amounts described in subparagraph (A) which are carried forward to such year.

"(d) PRE-CHANGE LOSS AND POST-CHANGE YEAR.—For purposes of this section—

"(1) PRE-CHANGE LOSS.—The term 'pre-change loss' means—

"(A) any net operating loss carryforward of the old loss corporation to the taxable year ending with the ownership change or in which the change date occurs, and

"(B) the net operating loss of the old loss corporation for the taxable year in which the ownership change occurs to the extent such loss is allocable to the period in such year on or before the change date.

Except as provided in subsection (h)(5) and in regulations, the net operating loss shall, for purposes of subparagraph (B), be allocated ratably to each day in the year.

"(2) POST-CHANGE YEAR.—The term 'post-change year' means any taxable year ending after the change date.

"(e) VALUE OF OLD LOSS CORPORATION.—For purposes of this section—

"(1) IN GENERAL.—Except as otherwise provided in this subsection, the value of the old loss corporation is the value of the stock of such corporation (including any stock described in section 1504(a)(4)) immediately before the ownership change.

"(2) SPECIAL RULE IN THE CASE OF REDEMPTION.—If a redemption occurs in connection with an ownership change, the value under paragraph (1) shall be determined after taking such redemption into account.

"(f) Long-Term Tax-Exempt Rate.—For purposes of this section—

"(1) In general.—The long-term tax-exempt rate shall be the highest of the adjusted Federal long-term rates in effect for any month in the 3-calendar-month period ending with the calendar month in which the change date occurs.

"(2) Adjusted federal long-term rate.—For purposes of paragraph (1), the term 'adjusted Federal long-term rate' means the Federal long-term rate determined under section 1274(d), except that—

"(A) paragraphs (2) and (3) thereof shall not apply, and

"(B) such rate shall be properly adjusted for differences between rates on long-term taxable and tax-exempt obligations.

"(g) Ownership Change.—For purposes of this section—

"(1) In general.—There is an ownership change if, immediately after any owner shift involving a 5-percent shareholder or any equity structure shift—

"(A) the percentage of the stock of the new loss corporation owned by 1 or more 5-percent shareholders has increased by more than 50 percentage points, over

"(B) the lowest percentage of stock of the old loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.

"(2) Owner shift involving 5-percent shareholder.—There is an owner shift involving a 5-percent shareholder if—

"(A) there is any change in the respective ownership of stock of a corporation, and

"(B) such change affects the percentage of stock of such corporation owned by any person who is a 5-percent shareholder before or after such change.

"(3) Equity structure shift defined.—

"(A) In general.—The term 'equity structure shift' means any reorganization (within the meaning of section 368). Such term shall not include—

"(i) any reorganization described in subparagraph (D) or (G) of section 368(a)(1) unless the requirements of section 354(b)(1) are met, and

"(ii) any reorganization described in subparagraph (F) of section 368(a)(1).

"(B) Taxable reorganization-type transactions, etc.—To the extent provided in regulations, the term 'equity structure shift' includes taxable reorganization-type transactions, public offerings, and similar transactions.

"(4) Special rules for application of subsection.—

"(A) Treatment of less than 5-percent shareholders.—Except as provided in subparagraphs (B)(i) and (C), in determining whether an ownership change has occurred, all stock owned by shareholders of a corporation who are not 5-percent shareholders of such corporation shall be treated as stock owned by 1 5-percent shareholder of such corporation.

"(B) COORDINATION WITH EQUITY STRUCTURE SHIFTS.—For purposes of determining whether an equity structure shift (or subsequent transaction) is an ownership change—

"(i) LESS THAN 5-PERCENT SHAREHOLDERS.—Subparagraph (A) shall be applied separately with respect to each group of shareholders (immediately before such equity structure shift) of each corporation which was a party to the reorganization involved in such equity structure shift.

"(ii) ACQUISITIONS OF STOCK.—Unless a different proportion is established, acquisitions of stock after such equity structure shift shall be treated as being made proportionately from all shareholders immediately before such acquisition.

"(C) COORDINATION WITH OTHER OWNER SHIFTS.—Except as provided in regulations, the rules of subparagraph (B) shall apply in determining whether there has been an owner shift involving a 5-percent shareholder and whether such shift (or subsequent transaction) results in an ownership change.

"(h) SPECIAL RULES FOR BUILT-IN GAINS AND LOSSES AND SECTION 338 GAINS.—For purposes of this section—

"(1) IN GENERAL.—

"(A) NET UNREALIZED BUILT-IN GAIN.—

"(i) IN GENERAL.—If the old loss corporation has a net unrealized built-in gain, the section 382 limitation for any recognition period taxable year shall be increased by the recognized built-in gains for such taxable year.

"(ii) LIMITATION.—The increase under clause (i) for any recognition period taxable year shall not exceed—

"(I) the net unrealized built-in gain, reduced by

"(II) recognized built-in gains for prior years ending in the recognition period.

"(B) NET UNREALIZED BUILT-IN LOSS.—

"(i) IN GENERAL.—If the old loss corporation has a net unrealized built-in loss, the recognized built-in loss for any recognition period taxable year shall be subject to limitation under this section in the same manner as if such loss were a pre-change loss.

"(ii) LIMITATION.—Clause (i) shall apply to recognized built-in losses for any recognition period taxable year only to the extent such losses do not exceed—

"(I) the net unrealized built-in loss, reduced by

"(II) recognized built-in losses for prior taxable years ending in the recognition period.

"(C) SECTION 338 GAIN.—The section 382 limitation for any taxable year in which gain is recognized by reason of an election under section 338 shall be increased by the excess of—

"(i) the amount of such gain, over

"(ii) the portion of such gain taken into account in computing recognized built-in gains for such taxable year.

"(2) RECOGNIZED BUILT-IN GAIN AND LOSS.—

"(A) RECOGNIZED BUILT-IN GAIN.—The term 'recognized built-in gain' means any gain recognized during the recognition period on the disposition of any asset to the extent the new loss corporation establishes that—

"(i) such asset was held by the old loss corporation immediately before the change date, and

"(ii) such gain does not exceed the excess of—

"(I) the fair market value of such asset on the change date, over

"(II) the adjusted basis of such asset on such date.

"(B) RECOGNIZED BUILT-IN LOSS.—The term 'recognized built-in loss' means any loss recognized during the recognition period on the disposition of any asset except to the extent the new loss corporation establishes that—

"(i) such asset was not held by the old loss corporation immediately before the change date, or

"(ii) such loss exceeds the excess of—

"(I) the adjusted basis of such asset on the change date, over

"(II) the fair market value of such asset on such date.

"(3) NET UNREALIZED BUILT-IN GAIN AND LOSS DEFINED.—

"(A) NET UNREALIZED BUILT-IN GAIN AND LOSS.—

"(i) IN GENERAL.—The terms 'net unrealized built-in gain' and 'net unrealized built-in loss' mean, with respect to any old loss corporation, the amount by which—

"(I) the fair market value of the assets of such corporation immediately before an ownership change is more or less, respectively, than

"(II) the aggregate adjusted basis of such assets at such time.

"(ii) SPECIAL RULE FOR REDEMPTIONS.—If a redemption occurs in connection with an ownership change, determinations under clause (i) shall be made after taking such redemption into account.

"(B) THRESHOLD REQUIREMENT.—

"(i) If the amount of the net unrealized built-in gain or net unrealized built-in loss (determined without regard to this subparagraph) of any old loss corporation is not greater than 25 percent of the amount determined for purposes of subparagraph (A)(i)(I), the net unrealized built-in gain or net unrealized built-in loss shall be zero.

"(ii) CASH AND CASH ITEMS NOT TAKEN INTO ACCOUNT.—In computing any net unrealized built-in gain or net unrealized built-in loss under clause (i), there shall not be taken into account—

"(I) any cash or cash item, or

"(II) any marketable security which has a value which does not substantially differ from adjusted basis.

"(4) DISALLOWED LOSS TREATED AS A NET OPERATING LOSS.—If a deduction for any portion of a recognized built-in loss is disallowed for any post-change year, such portion—

"(A) shall be carried forward to subsequent taxable years under rules similar to the rules for the carrying forward of net operating losses, but

"(B) shall be subject to limitation under this section in the same manner as a pre-change loss.

"(5) SPECIAL RULES FOR POST-CHANGE YEAR WHICH INCLUDES CHANGE DATE.—For purposes of subsection (b)(3)—

"(A) in applying subparagraph (A) thereof, taxable income shall be computed without regard to recognized built-in gains and losses, and gain described in paragraph (1)(C), for the year, and

"(B) in applying subparagraph (B) thereof, the section 382 limitation shall be computed without regard to recognized built-in gains, and gain described in paragraph (1)(C), for the year.

"(6) SECRETARY MAY TREAT CERTAIN DEDUCTIONS AS BUILT-IN LOSSES.—The Secretary may by regulation treat amounts which accrue on or before the change date but which are allowable as a deduction after such date as recognized built-in losses.

"(7) RECOGNITION PERIOD, ETC.—

"(A) RECOGNITION PERIOD.—The term 'recognition period' means, with respect to any ownership change, the 5-year period beginning on the change date.

"(B) RECOGNITION PERIOD TAXABLE YEAR.—The term 'recognition period taxable year' means any taxable year any portion of which is in the recognition period.

"(8) DETERMINATION OF FAIR MARKET VALUE IN CERTAIN CASES.—If 80 percent or more in value of the stock of a corporation is acquired in 1 transaction (or in a series of related transactions during any 12-month period), for purposes of determining the net unrealized built-in loss, the fair market value of the assets of such corporation shall not exceed the grossed up amount paid for such stock properly adjusted for indebtedness of the corporation and other relevant items.

"(9) TAX-FREE EXCHANGES OR TRANSFERS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection where property held on the change date is transferred in a transaction where gain or loss is not recognized (in whole or in part).

"(i) TESTING PERIOD.—For purposes of this section—

"(1) 3-YEAR PERIOD.—Except as otherwise provided in this section, the testing period is the 3-year period ending on the day of any owner shift involving a 5-percent shareholder or equity structure shift.

"(2) SHORTER PERIOD WHERE THERE HAS BEEN RECENT OWNERSHIP CHANGE.—If there has been an ownership change under this section, the testing period for determining whether a 2nd ownership change has occurred shall not begin before the 1st day following the change date for such earlier ownership change.

"(3) SHORTER PERIOD WHERE ALL LOSSES ARISE AFTER 3-YEAR PERIOD BEGINS.—The testing period shall not begin before the 1st day of the 1st taxable year from which there is a carryforward of a loss or of an excess credit to the 1st post-change year. Except as provided in regulations, this paragraph shall not apply to any loss corporation which has a net unrealized built-in loss (determined after application of subsection (h)(3)(B)).

"(j) CHANGE DATE.—For purposes of this section, the change date is—

"(1) in the case where the last component of an ownership change is an owner shift involving a 5-percent shareholder, the date on which such shift occurs, and

"(2) in the case where the last component of an ownership change is an equity structure shift, the date of the reorganization.

"(k) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) LOSS CORPORATION.—The term 'loss corporation' means a corporation entitled to use a net operating loss carryover. Except to the extent provided in regulations, such term includes any corporation with a net unrealized built-in loss.

"(2) OLD LOSS CORPORATION.—The term 'old loss corporation' means any corporation with respect to which there is an ownership change—

"(A) which (before the ownership change) was a loss corporation, or

"(B) with respect to which there is a pre-change loss described in subsection (d)(1)(B).

"(3) NEW LOSS CORPORATION.—The term 'new loss corporation' means a corporation which (after an ownership change) is a loss corporation. Nothing in this section shall be treated as implying that the same corporation may not be both the old loss corporation and the new loss corporation.

"(4) TAXABLE INCOME.—Taxable income shall be computed with the modifications set forth in section 172(d).

"(5) VALUE.—The term 'value' means fair market value.

"(6) RULES RELATING TO STOCK.—

"(A) PREFERRED STOCK.—Except as provided in regulations and subsection (e), the term 'stock' means stock other than stock described in section 1504(a)(4).

"(B) TREATMENT OF CERTAIN RIGHTS, ETC.—The Secretary shall prescribe such regulations as may be necessary—

"(i) to treat warrants, options, contracts to acquire stock, convertible debt interests, and other similar interests as stock, and

"(ii) to treat stock as not stock.

"(C) DETERMINATIONS ON BASIS OF VALUE.—Determinations of the percentage of stock of any corporation held by any person shall be made on the basis of value.

"(7) 5-PERCENT SHAREHOLDER.—The term '5-percent shareholder' means any person holding 5 percent or more of the stock of the corporation at any time during the testing period.

"(l) CERTAIN ADDITIONAL OPERATING RULES.—For purposes of this section—

"(1) CERTAIN CAPITAL CONTRIBUTIONS NOT TAKEN INTO ACCOUNT.—

"(A) IN GENERAL.—Any capital contribution received by an old loss corporation as part of a plan a principal purpose of which is to avoid or increase any limitation under this section shall not be taken into account for purposes of this section.

"(B) CERTAIN CONTRIBUTIONS TREATED AS PART OF PLAN.—For purposes of subparagraph (A), any capital contribution made during the 2-year period ending on the change date shall, except as provided in regulations, be treated as part of a plan described in subparagraph (A).

"(2) ORDERING RULES FOR APPLICATION OF SECTION.—

"(A) COORDINATION WITH SECTION 172(b) CARRYOVER RULES.—In the case of any pre-change loss for any taxable year (hereinafter in this subparagraph referred to as the 'loss year') subject to limitation under this section, for purposes of determining under the 2nd sentence of section 172(b)(2) the amount of such loss which may be carried to any taxable year, taxable income for any taxable year shall be treated as not greater than—

"(i) the section 382 limitation for such taxable year, reduced by

"(ii) the unused pre-change losses for taxable years preceding the loss year.

Similar rules shall apply in the case of any credit or loss subject to limitation under section 383.

"(B) ORDERING RULE FOR LOSSES CARRIED FROM SAME TAXABLE YEAR.—In any case in which—

"(i) a pre-change loss of a loss corporation for any taxable year is subject to a section 382 limitation, and

"(ii) a net operating loss of such corporation from such taxable year is not subject to such limitation,

taxable income shall be treated as having been offset first by the loss subject to such limitation.

"(3) OPERATING RULES RELATING TO OWNERSHIP OF STOCK.—

"(A) CONSTRUCTIVE OWNERSHIP.—Section 318 (relating to constructive ownership of stock) shall apply in determining ownership of stock, except that—

"(i) paragraphs (1) and (5)(B) of section 318(a) shall not apply and an individual and all members of his family described in paragraph (1) of section 318(a) shall be treated as 1 individual for purposes of applying this section,

"(ii) paragraph (2) of section 318(a) shall be applied—

"(I) without regard to the 50-percent limitation contained in subparagraph (C) thereof, and

"(II) except as provided in regulations, by treating stock attributed thereunder as no longer being held by the entity from which attributed,

"(iii) paragraph (3) of section 318(a) shall be applied only to the extent provided in regulations, and *"(iv) except to the extent provided in regulations, paragraph (4) of section 318(a) shall apply to an option if such application results in an ownership change.*

A rule similar to the rule of clause (iv) shall apply in the case of any contingent purchase, warrant, convertible debt, put, stock subject to a risk of forfeiture, contract to acquire stock, or similar interests.

"(B) STOCK ACQUIRED BY REASON OF DEATH, GIFT, DIVORCE, SEPARATION, ETC.—If—

"(i) the basis of any stock in the hands of any person is determined—

"(I) under section 1014 (relating to property acquired from a decedent),

"(II) section 1015 (relating to property acquired by a gift or transfer in trust), or

"(III) section 1041(b)(2) (relating to transfers of property between spouses or incident to divorce,

"(ii) stock is received by any person in satisfaction of a right to receive a pecuniary bequest, or

"(iii) stock is acquired by a person pursuant to any divorce or separation instrument (within the meaning of section 71(b)(2)),

such person shall be treated as owning such stock during the period such stock was owned by the person from whom it was acquired.

"(C) SPECIAL RULE FOR EMPLOYEE STOCK OWNERSHIP PLANS.—

"(i) IN GENERAL.—Except as provided in clause (ii), the acquisition of employer securities (within the meaning of section 409(l)) by—

"(I) a tax credit employee stock ownership plan or an employee stock ownership plan (within the meaning of section 4975(e)(7)), or

"(II) a participant of any such plan pursuant to the requirements of section 409(h),

shall not be taken into account in determining whether an ownership change has occurred.

"(ii) OWNERSHIP AND ALLOCATION REQUIREMENTS.—Subclause (I) of clause (i) shall not apply to any acquisition unless—

"(I) immediately after such acquisition the plan holds stock meeting the requirements of section 1042(b)(2), except that such section shall be applied by substituting '50 percent' for '30 percent', and

"(II) the plan meets requirements similar to the requirements of section 409(n).

"(D) CERTAIN CHANGES IN PERCENTAGE OWNERSHIP WHICH ARE ATTRIBUTABLE TO FLUCTUATIONS IN VALUE NOT TAKEN INTO ACCOUNT.—Except as provided in regulations, any change in proportionate ownership which is attributable solely to fluctuations in the relative fair market values of different classes of stock shall not be taken into account.

"(4) REDUCTION IN VALUE WHERE SUBSTANTIAL NONBUSINESS ASSETS.—

"(A) In general.—If, immediately after an ownership change, the new loss corporation has substantial nonbusiness assets, the value of the old loss corporation shall be reduced by the excess (if any) of—

"(i) the fair market value of the nonbusiness assets of the old loss corporation, over

"(ii) the nonbusiness asset share of indebtedness for which such corporation is liable.

"(B) Corporation having substantial nonbusiness assets.—For purposes of subparagraph (A)—

"(i) In general.—The old loss corporation shall be treated as having substantial nonbusiness assets if at least ⅓ of the value of the total assets of such corporation consists of nonbusiness assets.

"(ii) Exception for certain investment entities.—A regulated investment company to which part I of subchapter M applies, a real estate investment trust to which part II of subchapter M applies, or a real estate mortgage pool to which part IV of subchapter M applies, shall not be treated as a new loss corporation having substantial nonbusiness assets.

"(C) Nonbusiness assets.—For purposes of this paragraph, the term 'nonbusiness assets' means assets held for investment.

"(D) Nonbusiness asset share.—For purposes of this paragraph, the nonbusiness asset share of the indebtedness of the corporation is an amount which bears the same ratio to such indebtedness as—

"(i) the fair market value of the nonbusiness assets of the corporation, bears to

"(ii) the fair market value of all assets of such corporation.

"(E) Treatment of subsidiaries.—For purposes of this paragraph, stock and securities in any subsidiary corporation shall be disregarded and the parent corporation shall be deemed to own its ratable share of the subsidiary's assets. For purposes of the preceding sentence, a corporation shall be treated as a subsidiary if the parent owns 50 percent or more of the combined voting power of all classes of stock entitled to vote, and 50 percent or more of the total value of shares of all classes of stock.

"(5) Title 11 or similar case.—

"(A) In general.—Subsection (a) shall not apply to any ownership change if—

"(i) the old loss corporation is (immediately before such ownership change) under the jurisdiction of the court in a title 11 or similar case, and

"(ii) the shareholders and creditors of the old loss corporation (determined immediately before such ownership change) own (immediately after such ownership change) stock of the new loss corporation (or stock of controlling corporation if also in bankruptcy) which meets the requirements of section 1504(a)(2) (determined

by substituting '50 percent' for '80 percent' each place it appears).

"(B) Reduction for interest payments to creditors becoming shareholders.—In any case to which subparagraph (A) applies, the net operating loss deduction under section 172(a) for any post-change year shall be determined as if no deduction was allowable under this chapter for the interest paid or accrued by the old loss corporation on indebtedness which was converted into stock pursuant to title 11 or similar case during—

"(i) any taxable year ending during the 3-year period preceding the taxable year in which the ownership change occurs, and

"(ii) the period of the taxable year in which the ownership change occurs on or before the change date.

"(C) Reduction of carryforwards where discharge of indebtedness.—In any case to which subparagraph (A) applies, the pre-change losses and excess credits (within the meaning of section 383(a)(2)) which may be carried to a post-change year shall be computed as if 50 percent of the amount which, but for the application of section 108(e)(10)(B), would have been includible in gross income for any taxable year had been so included.

"(D) Section 382 limitation zero if another change within 2 years.—If, during the 2-year period immediately following an ownership change to which this paragraph applies, an ownership change of the new loss corporation occurs, this paragraph shall not apply and the section 382 limitation with respect to the 2nd ownership change for any post-change year ending after the change date of the 2nd ownership change shall be zero.

"(E) Only certain stock of creditors taken into account.—For purposes of subparagraph (A)(ii), stock transferred to a creditor in satisfaction of indebtedness shall be taken into account only if such indebtedness—

"(i) was held by the creditor at least 18 months before the date of the filing of the title 11 or similar case, or

"(ii) arose in the ordinary course of the trade or business of the old loss corporation and is held by the person who at all times held the beneficial interest in such indebtedness.

"(F) Special rule for certain financial institutions.—

"(i) In general.—In the case of any ownership change to which this subparagraph applies, this paragraph shall be applied—

"(I) by substituting '20 percent' for '50 percent' in subparagraph (A)(ii), and

"(II) without regard to subparagraphs (B) and (C).

"(ii) Special rule for depositors.—For purposes of applying this paragraph to an ownership change to which this subparagraph applies—

"(I) a depositor in the old loss corporation shall be treated as a stockholder in such loss corporation immediately before the change,

"(II) deposits which, after the change, become deposits of the new loss corporation shall be treated as stock of the new loss corporation, and

"(III) the fair market value of the outstanding stock of the new loss corporation shall include deposits described in subclause (II).

"(iii) CHANGES TO WHICH SUBPARAGRAPH APPLIES.—This subparagraph shall apply to—

"(I) an equity structure shift which is a reorganization described in section 368(a)(3)(D)(ii), or

"(II) any other equity structure shift (or transaction to which section 351 applies) which occurs as an integral part of a transaction involving a change to which subclause (I) applies.

This subparagraph shall not apply to any equity structure shift or transaction occurring after December 31, 1988.

"(G) TITLE 11 OR SIMILAR CASE.—For purposes of this paragraph, the term 'title 11 or similar case' has the meaning given such term by section 368(a)(3)(A).

"(H) ELECTION NOT TO HAVE PARAGRAPH APPLY.—A new loss corporation may elect, subject to such terms and conditions as the Secretary may prescribe, not to have the provisions of this paragraph apply.

"(6) SPECIAL RULE FOR INSOLVENCY TRANSACTIONS.—If paragraph (5) does not apply to any reorganization described in subparagraph (G) of section 368(a)(1) or any exchange of debt for stock in a title 11 or similar case (as defined in section 368(a)(3)(A)), the value under subsection (e) shall be the value of the new loss corporation immediately after the ownership change.

"(7) COORDINATION WITH ALTERNATIVE MINIMUM TAX.—The Secretary shall by regulation provide for the application of this section to the alternative tax net operating loss deduction under section 56(d).

"(m) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section and section 383, including (but not limited to) regulations—

"(1) providing for the application of this section and section 383 where an ownership change with respect to the old loss corporation is followed by an ownership change with respect to the new loss corporation, and

"(2) providing for the application of this section and section 383 in the case of a short taxable year,

"(3) providing for such adjustments to the application of this section and section 383 as is necessary to prevent the avoidance of the purposes of this section and section 383, including the avoidance of such purposes through the use of related persons, pass-thru entities, or other intermediaries,

"(4) providing for the treatment of corporate contractions as redemptions for purposes of subsections (e)(2) and (h)(3)(A), and

"(5) providing for the application of subsection (g)(4) where there is only 1 corporation involved."

(b) AMENDMENT OF SECTION 383.—Section 383 (relating to special limitations on unused investment credits, etc.) is amended to read as follows:

"SEC. 383. SPECIAL LIMITATIONS ON CERTAIN EXCESS CREDITS, ETC.

"(a) EXCESS CREDITS.—

"(1) IN GENERAL.—Under regulations, if an ownership change occurs with respect to a corporation, the amount of any excess credit for any taxable year which may be used in any post-change year shall be limited to an amount determined on the basis of the tax liability which is attributable to so much of the taxable income as does not exceed the section 382 limitation for such post-change year to the extent available after the application of section 382 and subsections (b) and (c) of this section.

"(2) EXCESS CREDIT.—For purposes of paragraph (1), the term 'excess credit' means—

"(A) any unused general business credit of the corporation under section 39, and

"(B) any unused minimum tax credit of the corporation under section 53.

"(b) LIMITATION ON NET CAPITAL LOSS.—If an ownership change occurs with respect to a corporation, the amount of any net capital loss under section 1212 for any taxable year before the 1st post-change year which may be used in any post-change year shall be limited under regulations which shall be based on the principles applicable under section 382. Such regulations shall provide that any such net capital loss used in a post-change year shall reduce the section 382 limitation which is applied to pre-change losses under section 382 for such year.

"(c) FOREIGN TAX CREDITS.—If an ownership change occurs with respect to a corporation, the amount of any excess foreign taxes under section 904(c) for any taxable year before the 1st post-change taxable year shall be limited under regulations which shall be consistent with purposes of this section and section 382.

"(d) PRO RATION RULES FOR YEAR WHICH INCLUDES CHANGE.—For purposes of this section, rules similar to the rules of subsections (b)(3) and (d)(1)(B) of section 382 shall apply.

"(e) DEFINITIONS.—Terms used in this section shall have the same respective meanings as when used in section 382, except that appropriate adjustments shall be made to take into account that the limitations of this section apply to credits and net capital losses."

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (5) of section 318(b) is amended by striking out "section 382(a)(3)" and inserting in lieu thereof "section 382(l)(3)".

(2) The table of sections for part V of subchapter C of chapter 1 is amended—

(A) by striking out the item relating to section 382 and inserting in lieu thereof the following new item:

"Sec. 382. Limitation on net operating loss carryforwards and certain *built-in losses following ownership change.".*

and

(B) by striking out the item relating to section 383 and inserting in lieu thereof the following new item:

"Sec. 383. Special limitations on certain excess credits, etc.".

(d) Report on Depreciation and Built-In Deductions; Report on Bankruptcy Workouts.—The Secretary of the Treasury or his delegate—

(1) shall, not later than January 1, 1989, conduct a study and report to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate with respect to the treatment of depreciation, amortization, depletion, and other built-in deductions for purposes of sections 382 and 383 of the Internal Revenue Code of 1986 (as amended by this section), and

(2) shall, not later than January 1, 1988, conduct a study and report to the committees referred to in paragraph (1) with respect to the treatment of informal bankruptcy workouts for purposes of sections 108 and 382 of such Code.

(e) Repeal of Changes Made by Tax Reform Act of 1976.—

(1) Subsections (e) and (f) of section 806 of the Tax Reform Act of 1976 (including the amendment treated as part of such subsections under section 59(b) of the Tax Reform Act of 1984) are hereby repealed.

(2) Subsection (g) of such section 806 is amended by striking out paragraphs (2) and (3).

(f) Effective Dates.—

(1) In general.—The amendments made by subsections (a), (b), and (c) shall apply to any ownership change following—

(A) an owner shift involving a 5-percent shareholder occurring after December 31, 1986, or

(B) an equity structure shift occurring pursuant to a plan of reorganization adopted after December 31, 1986.

(2) For amendments to tax reform act of 1976.—

(A) In general.—The repeals made by subsection (e)(1) and the amendment made by subsection (e)(2) shall take effect on January 1, 1986.

(B) Election to have amendments apply.—

(i) If a taxpayer described in clause (ii) elects to have the provisions of this subparagraph apply, the amendments made by subsections (e) and (f) of section 806 of the Tax Reform Act of 1976 shall apply to the reorganization described in clause (ii).

(ii) A taxpayer is described in this clause if the taxpayer filed a title 11 or similar case on December 8, 1981, filed a plan of reorganization on February 5, 1986, filed an amended plan on March 14, 1986, and received court approval for the amended plan and disclosure statement on April 16, 1986.

(C) Application of old rules to certain debt.—In the case of debt of a corporation incorporated in Colorado on November 8, 1924, with headquarters in Denver, Colorado—

(i) the amendments made by subsections (a), (b), and (c) shall not apply to any debt restructuring of such debt which was approved by the debtor's Board of Directors and the lenders in 1986, and

(ii) the amendments made by subsections (e) and (f) of section 806 of the Tax Reform Act of 1976 (including the amendment treated as part of such subsections under section 59(b) of the Tax Reform Act of 1984) shall apply to such debt restructuring.

(D) SPECIAL RULE FOR OIL AND GAS WELL DRILLING BUSINESS.—In the case of a Texas corporation incorporated on July 23, 1935, in applying section 382 of the Internal Revenue Code of 1986 (as in effect before and after the amendments made by subsections (a), (b), and (c)) to a loan restructuring agreement during 1985, section 382(a)(5)(C) of the Internal Revenue Code of 1954 (as added by the amendments made by subsections (e) and (f) of section 806 of the Tax Reform Act of 1976) shall be applied as if it were in effect with respect to such restructuring or reorganization.

(3) TESTING PERIOD.—For purposes of determining whether there is an ownership change after December 31, 1986, the testing period shall not begin before the later of—

(A) May 6, 1986, or

(B) in the case of an ownership change which occurs after May 5, 1986, and to which the amendments made by subsections (a), (b), and (c) do not apply, the first day following the date on which such ownership change occurs.

(4) SPECIAL TRANSITION RULES.—The amendments made by subsections (a), (b), and (c) shall not apply to any—

(A) stock-for-debt exchanges and stock sales made pursuant to a plan of reorganization with respect to a petition for reorganization filed by a corporation under chapter 11 of title 11, United States Code, on August 26, 1982, and which filed with a United States district court a first amended and related plan of reorganization before March 1, 1986, or

(B) ownership change of a Delaware corporation incorporated in August 1983, which may result from the exercise of put or call option under an agreement entered into on September 14, 1983, but only with respect to taxable years beginning after 1991 regardless of when such ownership change takes place.

Any regulations prescribed under section 382(g)(3)(B) of the Internal Revenue Code of 1986 (as amended by subsection (a)) shall not apply with respect to domestic building and loan trasactions for any period before January 1, 1989.

(5) BANKRUPTCY PROCEEDINGS.—In the case of a reorganization described in subparagraph (G) of section 368(a)(1) of the Internal Revenue Code of 1986 or an exchange of debt for stock in a title 11 or similar case, as defined in section 368(a)(3) of such Code, the amendments made by subsections (a), (b), and (c) shall not apply to any ownership change resulting from such a reorganization or proceeding if a petition in such case was filed with the court before August 14, 1986.

(6) Certain plans.—The amendments made by subsections (a), (b), and (c) shall not apply to any ownership change with respect to—

(A) the acquisition of a corporation the stock of which is acquired pursuant to a plan of divestiture which identified such corporation and its assets, and was agreed to by the board of directors of such corporation's parent corporation on May 17, 1985,

(B) a merger which occurs pursuant to a merger agreement (entered into before September 24, 1985) and an application for approval by the Federal Home Loan Bank Board was filed on October 4, 1985,

(C) a reorganization involving a party to a reorganization of a group of corporations engaged in enhanced oil recovery operations in California, merged in furtherance of a plan of reorganization adopted by a board of directors vote on September 24, 1985, and a Delaware corporation whose principal oil and gas producing fields are located in California, or

(D) the conversion of a mutual savings and loan association holding a Federal charter dated March 22, 1985, to a stock savings and loan association pursuant to the rules and regulations of the Federal Home Loan Bank Board.

(7) Ownership change of regulated air carrier.—The amendments made by subsections (a), (b), and (c) shall not apply to an ownership change of a regulated air carrier if—

(A) on July 16, 1986, at least 40 percent of the outstanding common stock (excluding all preferred stock, whether or not convertible) of such carrier had been acquired by the parent corporation referred to in section 203(d)(13)(B), and

(B) the acquisition (by or for such parent corporation) or retirement of the remaining common stock of such carrier is completed before the later of March 31, 1987, or 90 days after the requisite governmental approvals are finally granted,

but only if the ownership change occurs on or before the later of March 31, 1987, or such 90th day. The aggregate reduction in tax for any taxable year by reason of this paragraph shall not exceed $10,000,000. The testing period for determining whether a subsequent ownership change has occurred shall not begin before the 1st day following an ownership change to which this paragraph applies.

(8) The amendments made by subsections (a), (b), and (c) shall not apply to any ownership change resulting from the conversion of a Minnesota mutual savings bank holding a Federal charter dated December 31, 1985, to a stock savings bank pursuant to the rules and regulations of the Federal Home Loan Bank Board, and from the issuance of stock pursuant to that conversion to a holding company incorporated in Delaware on February 21, 1984. For purposes of determining whether any ownership change occurs with respect to the holding company or any subsidiary thereof (whether resulting from the transaction described in the preceding sentence or otherwise), any issuance of stock made by such holding company in connection with

the transaction described in the preceding sentence shall not be taken into account.

(9) DEFINITIONS.—Except as otherwise provided, terms used in this subsection shall have the same meaning as when used in section 382 of the Internal Revenue Code of 1986 (as amended by this section).

Subtitle D—Recognition of Gain and Loss on Distributions of Property in Liquidation

SEC. 631. RECOGNITION OF GAIN AND LOSS ON DISTRIBUTIONS OF PROPERTY IN LIQUIDATION.

(a) GENERAL RULE.—Subpart B of part II of subchapter C (relating to effects on corporation) is amended by striking out sections 336 and 337 and inserting in lieu thereof the following:

"SEC. 336. GAIN OR LOSS RECOGNIZED ON PROPERTY DISTRIBUTED IN COMPLETE LIQUIDATION.

"(a) GENERAL RULE.—Except as otherwise provided in this section or section 337, gain or loss shall be recognized to a liquidating corporation on the distribution of property in complete liquidation as if such property were sold to the distributee at its fair market value.

"(b) TREATMENT OF LIABILITIES IN EXCESS OF BASIS.—If any property distributed in the liquidation is subject to a liability or the shareholder assumes a liability of the liquidating corporation in connection with the distribution, for purposes of subsection (a) and section 337, the fair market value of such property shall be treated as not less than the amount of such liability.

"(c) EXCEPTION FOR CERTAIN LIQUIDATIONS TO WHICH PART III APPLIES.—This section shall not apply with respect to any distribution of property to the extent there is nonrecognition of gain or loss with respect to such property to the recipient under part III.

"(d) LIMITATIONS ON RECOGNITION OF LOSS.—

"(1) NO LOSS RECOGNIZED IN CERTAIN DISTRIBUTIONS TO RELATED PERSONS.—

"(A) IN GENERAL.—No loss shall be recognized to a liquidating corporation on the distribution of any property to a related person (within the meaning of section 267) if—

"(i) such distribution is not pro rata, or

"(ii) such property is disqualified property.

"(B) DISQUALIFIED PROPERTY.—For purposes of subparagraph (A), the term 'disqualified property' means any property which is acquired by the liquidating corporation in a transaction to which section 351 applied, or as a contribution to capital, during the 5-year period ending on the date of the distribution. Such term includes any property if the adjusted basis of such property is determined (in whole or in part) by reference to the adjusted basis of property described in the preceding sentence.

"(2) SPECIAL RULE FOR CERTAIN PROPERTY ACQUIRED IN CERTAIN CARRYOVER BASIS TRANSACTIONS.—

"(A) IN GENERAL.—For purposes of determining the amount of loss recognized by any liquidating corporation

on any sale, exchange, or distribution of property described in subparagraph (B), the adjusted basis of such property shall be reduced (but not below zero) by the excess (if any) of—

"(i) the adjusted basis of such property immediately after its acquisition by such corporation, over

"(ii) the fair market value of such property as of such time.

"(B) Description of Property.—

"(i) In general.—For purposes of subparagraph (A), property is described in this subparagraph if—

"(I) such property is acquired by the liquidating corporation in a transaction to which section 351 applied or as a contribution to capital, and

"(II) the acquisition of such property by the liquidating corporation was part of a plan a principal purpose of which was to recognize loss by the liquidating corporation with respect to such property in connection with the liquidation.

Other property shall be treated as so described if the adjusted basis of such other property is determined (in whole or in part) by reference to the adjusted basis of property described in the preceding sentence.

"(ii) Certain acquisitions treated as part of plan.—For purposes of clause (i), any property described in clause (i)(I) acquired by the liquidating corporation during the 2-year period ending on the date of the adoption of the plan of complete liquidation shall, except as provided in regulations, be treated as part of a plan described in clause (i)(II).

"(C) Recapture in lieu of disallowance.—The Secretary may prescribe regulations under which, in lieu of disallowing a loss under subparagraph (A) for a prior taxable year, the gross income of the liquidating corporation for the taxable year in which the plan of complete liquidation is adopted shall be increased by the amount of the disallowed loss.

"(3) Special rule in case of liquidation to which section 332 applies.—In the case of any liquidation to which section 332 applies, no loss shall be recognized to the liquidating corporation on any distribution in such liquidation.

"(e) Certain Stock Sales and Distributions May Be Treated As Asset Transfers.—Under regulations prescribed by the Secretary, if—

"(1) a corporation owns stock in another corporation meeting the requirements of section 1504(a)(2), and

"(2) such corporation sells, exchanges, or distributes all of such stock,

such corporation may elect to treat such sale, exchange, or distribution as a disposition of all of the assets of such other corporation, and no gain or loss shall be recognized on the sale, exchange, or distribution of such stock.

"SEC. 337. NONRECOGNITION FOR PROPERTY DISTRIBUTED TO PARENT IN COMPLETE LIQUIDATION OF SUBSIDIARY.

"(a) IN GENERAL.—No gain or loss shall be recognized to the liquidating corporation on the distribution to the 80-percent distributee of any property in a complete liquidation to which section 332 applies.

"(b) TREATMENT OF INDEBTEDNESS OF SUBSIDIARY, ETC.—

"(1) INDEBTEDNESS OF SUBSIDIARY TO PARENT.—If—

"(A) a corporation is liquidated in a liquidation to which section 332 applies, and

"(B) on the date of the adoption of the plan of liquidation, such corporation was indebted to the 80-percent distributee,

for purposes of this section and section 336, any transfer of property to the 80-percent distributee in satisfaction of such indebtedness shall be treated as a distribution to such distributee in such liquidation.

"(2) TREATMENT OF TAX-EXEMPT DISTRIBUTEE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), paragraph (1) and subsection (a) shall not apply where the 80-percent distributee is an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

"(B) EXCEPTION WHERE PROPERTY WILL BE USED IN UNRELATED BUSINESS.—

"(i) IN GENERAL.—Subparagraph (A) shall not apply to any distribution of property to an organization described in section 511(a)(2) or 511(b)(2) if, immediately after such distribution, such organization uses such property in an unrelated trade or business (as defined in section 513).

"(ii) LATER DISPOSITION OR CHANGE IN USE.—If any property to which clause (i) applied is disposed of by the organization acquiring such property, notwithstanding any other provision of law, any gain (not in excess of the amount not recognized by reason of clause (i) shall be included in such organization's unrelated business taxable income. For purposes of the preceding sentence, if such property ceases to be used in an unrelated trade or business of such organization, such organization shall be treated as having disposed of such property on the date of such cessation.

"(c) 80-PERCENT DISTRIBUTEE.—For purposes of this section, the term '80-percent distributee' means only the corporation which meets the 80-percent stock ownership requirements specified in section 332(b).

"(d) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made to this subpart by the Tax Reform Act of 1986, including—

"(1) regulations to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations and part III of this subchapter), and

"(2) regulations providing for appropriate coordination of the provisions of this section with the provisions of this title relating to taxation of foreign corporations and their shareholders."

(b) Amendments to Section 338.—

(1) Subsection (a) of section 338 (relating to certain stock purchases treated as asset acquisitions) is amended by striking out "to which section 337 applies".

(2) Subsection (c) of section 338 is hereby repealed.

(3) Subparagraph (B) of section 338(h)(10) is amended by adding at the end thereof the following new sentence:

> "To the extent provided in regulations, such term also includes any affiliated group of corporations which includes the target corporation (whether or not such group files a consolidated return)."

(c) Treatment of Distributions of Appreciated Property.—Section 311 is amended to read as follows:

"SEC. 311. TAXABILITY OF CORPORATION ON DISTRIBUTION.

"(a) General Rule.—Except as provided in subsection (b), no gain or loss shall be recognized to a corporation on the distribution, with respect to its stock, of—

"(1) its stock (or rights to acquire its stock), or

"(2) property.

"(b) Distributions of Appreciated Property.—

"(1) In general.—If—

"(A) a corporation distributes property (other than an obligation of such corporation) to a shareholder in a distribution to which subpart A applies, and

"(B) the fair market value of such property exceeds its adjusted basis (in the hands of the distributing corporation),

then gain shall be recognized to the distributing corporation as if such property were sold to the distributee at its fair market value.

"(2) Treatment of liabilities in excess of basis.—Rules similar to the rules of section 336(b) shall apply for purposes of this subsection."

(d) Treatment of Foreign Distributees.—

(1) Amendments to section 367.—Subsection (e) of section 367 is amended to read as follows:

"(e) Treatment of Distributions Described in Section 355 or Liquidations Under Section 332.—

"(1) Distributions described in section 355.—In the case of any distribution described in section 355 (or so much of section 356 as relates to section 355) by a domestic corporation to a person who is not a United States person, to the extent provided in regulations, gain shall be recognized under principles similar to the principles of this section.

"(2) Liquidations under section 332.—In the case of any liquidation to which section 332 applies, except as provided in regulations, subsections (a) and (b)(1) of section 337 shall not apply where the 80-percent distributee (as defined in section 337(c)) is a foreign corporation."

(2) Amendments to section 1248.—

(A) Subsection (e) of section 1248 is amended by striking out "Under regulations" and inserting in lieu thereof "Except as provided in regulations".

(B) Subsection (f) of section 1248 is amended by inserting "Except as provided in regulations prescribed by the Secretary—" after the subsection heading.

(e) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Paragraph (4) of section 312(n) (as redesignated by title XVIII) is amended to read as follows:

"(4) LIFO INVENTORY ADJUSTMENTS.—

"(A) IN GENERAL.—Earnings and profits shall be increased or decreased by the amount of any increase or decrease in the LIFO recapture amount as of the close of each taxable year; except that any decrease below the LIFO recapture amount as of the close of the taxable year preceding the 1st taxable year to which this paragraph applies to the taxpayer shall be taken into account only to the extent provided in regulations prescribed by the Secretary.

"(B) LIFO RECAPTURE AMOUNT.—For purposes of this paragraph, the term 'LIFO recapture amount' means the amount (if any) by which—

"(i) the inventory amount of the inventory assets under the first-in, first-out method authorized by section 471, exceeds

"(ii) the inventory amount of such assets under the LIFO method.

"(C) DEFINITIONS.—For purposes of this paragraph—

"(i) LIFO METHOD.—The term 'LIFO method' means the method authorized by section 472 (relating to last-in, first-out inventories).

"(ii) INVENTORY ASSETS.—The term 'inventory assets' means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

"(iii) INVENTORY AMOUNT.—The inventory amount of assets under the first-in, first-out method authorized by section 471 shall be determined—

"(I) if the corporation uses the retail method of valuing inventories under section 472, by using such method, or

"(II) if subclause (I) does not apply, by using cost or market, whichever is lower."

(2) Subsection (c) of section 332 is hereby repealed.

(3) Section 333 is hereby repealed.

(4)(A) Subsection (a) of section 334 is amended by striking out "(other than a distribution to which section 333 applies)".

(B) Subsection (c) of section 334 is hereby repealed.

(5) Paragraph (12) of section 338(h) is hereby repealed.

(6)(A) Subsection (e) of section 341 is amended by striking out paragraphs (2), (3), and (4).

(B) Paragraph (5) of section 341(e) is amended—

(i) by striking out "paragraphs (1), (2), and (4)" and inserting in lieu thereof "paragraph (1)", and

(ii) by striking out subparagraph (B).

(7) Subsection (b) of section 346 is amended by striking out "337,".

(8)(A) Subparagraphs (A) and (B) of section 453(h)(1) (relating to use of installment sales in section 337 liquidations) are amended to read as follows:

"(A) IN GENERAL.—If, in a liquidation to which section 331 applies, the shareholder receives (in exchange for the shareholder's stock) an installment obligation acquired in respect of a sale or exchange by the corporation during the 12-month period beginning on the date a plan of complete liquidation is adopted and the liquidation is completed during such 12-month period, then, for purposes of this section, the receipt of payments under such obligation (but not the receipt of such obligation) by the shareholder shall be treated as the receipt of payment for the stock.

"(B) OBLIGATIONS ATTRIBUTABLE TO SALE OF INVENTORY MUST RESULT FROM BULK SALE.—Subparagraph (A) shall not apply to an installment obligation acquired in respect of a sale or exchange of—

"(i) stock in trade of the corporation,

"(ii) other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year, and

"(iii) property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

unless such sale or exchange is to one person and involves substantially all of such property attributable to a trade or business of the corporation."

(B) Subparagraph (E) of section 453(h)(1) is amended to read as follows:

"(E) SALES BY LIQUIDATING SUBSIDIARIES.—For purposes of subparagraph (A), in the case of a controlling corporate shareholder (within the meaning of section 368(c)(1)) of a selling corporation, an obligation acquired in respect of a sale or exchange by the selling corporation shall be treated as so acquired by such controlling corporate shareholder. The preceding sentence shall be applied successively to each controlling corporate shareholder above such controlling corporate shareholder."

(C) The heading for section 453(h) is amended by striking out "SECTION 337" and inserting in lieu thereof "CERTAIN".

(9) Subsection (d) of section 453B is amended to read as follows:

"(d) EFFECT OF DISTRIBUTION IN LIQUIDATIONS TO WHICH SECTION 332 APPLIES.—If—

"(1) an installment obligation is distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies, and

"(2) the basis of such obligation in the hands of the distributee is determined under section 334(b)(1),

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation."

(10) Paragraph (5) of section 467(c) is amended by striking out "453B(d)(2),".

(11) Subsection (b) of section 852 is amended by adding at the end thereof the following new paragraph:

"(6) SECTION 311(b) NOT TO APPLY TO CERTAIN DISTRIBUTIONS.—Section 311(b) shall not apply to any distribution by a regulated investment company to which this part applies, if such distribution is in redemption of its stock upon the demand of the shareholder."

(12) Subsection (d) of section 897 is amended—

(A) by striking out paragraph (2),

(B) by striking out the heading for paragraph (1),

(C) by appropriately redesignating each subparagraph, clause, and subclause of paragraph (1) as a paragraph, subparagraph, or clause, as the case may be,

(D) by striking out "subparagraph (A)" in paragraph (2) (as so redesignated) and inserting in lieu thereof "paragraph (1)", and

(E) by striking out ", ETC.," in the subsection heading.

(13) Subsection (a) of section 1056 is amended by striking out the last sentence thereof.

(14) Paragraph (2) of section 1255(b) is amended by striking out "453B(d)(2)".

(15) Paragraph (3) of section 1276(c) is amended by striking out "334(c),".

(16) The table of sections for subpart A of part II of subchapter C of chapter 1 is amended by striking out the item relating to section 333.

(17) The table of sections for subpart B of part II of subchapter C of chapter 1 is amended by striking out the items relating to sections 336 and 337 and inserting in lieu thereof the following:

"Sec. 336. Gain or loss recognized on property distributed in complete liquidation.
"Sec. 337. Nonrecognition for property distributed to parent in complete liquidation of subsidiary."

SEC. 632. TREATMENT OF C CORPORATIONS ELECTING SUBCHAPTER S STATUS.

(a) GENERAL RULE.—Section 1374 (relating to tax imposed on certain capital gains) is amended to read as follows:

"SEC. 1374. TAX IMPOSED ON CERTAIN BUILT-IN GAINS.

"(a) GENERAL RULE.—If for any taxable year beginning in the recognition period an S corporation has a recognized built-in gain, there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation for such taxable year.

"(b) AMOUNT OF TAX.—

"(1) IN GENERAL.—The tax imposed by subsection (a) shall be a tax computed by applying the highest rate of tax specified in section 11(b) to the lesser of—

"(A) the recognized built-in gains of the S corporation for the taxable year, or

"(B) the amount which would be the taxable income of the corporation for such taxable year if such corporation were not an S corporation.

"(2) NET OPERATING LOSS CARRYFORWARDS FROM C YEARS ALLOWED.—Notwithstanding section 1371(b)(1), any net operating loss carryforward arising in a taxable year for which the corporation was a C corporation shall be allowed as a deduction against the lesser of the amounts referred to in subparagraph (A) or (B) of paragraph (1). For purposes of determining the amount of any such loss which may be carried to subsequent taxable years, the lesser of the amounts referred to in subparagraph (A) or (B) of paragraph (1) shall be treated as taxable income.

"(3) CREDITS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no credit shall be allowable under part IV of subchapter A of this chapter (other than under section 34) against the tax imposed by subsection (a).

"(B) BUSINESS CREDIT CARRYFORWARDS FROM C YEARS ALLOWED.—Notwithstanding section 1371(b)(1), any business credit carryforward under section 39 arising in a taxable year for which the corporation was a C corporation shall be allowed as a credit against the tax imposed by subsection (a) in the same manner as if it were imposed by section 11.

"(4) COORDINATION WITH SECTION 1201(a).—For purposes of section 1201(a)—

"(A) the tax imposed by subsection (a) shall be treated as if it were imposed by section 11, and

"(B) the lower of the amounts specified in subparagraphs (A) and (B) of paragraph (1) shall be treated as the taxable income.

"(c) LIMITATIONS.—

"(1) CORPORATIONS WHICH WERE ALWAYS S CORPORATIONS.—Subsection (a) shall not apply to any corporation if an election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years. Except as provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of the preceding sentence.

"(2) LIMITATION ON AMOUNT OF RECOGNIZED BUILT-IN GAINS.—The amount of the recognized built-in gains taken into account under this section for any taxable year shall not exceed the excess (if any) of—

"(A) the net unrealized built-in gain, over

"(B) the recognized built-in gains for prior taxable years beginning in the recognition period.

"(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) NET UNREALIZED BUILT-IN GAIN.—The term 'net unrealized built-in gain' means the amount (if any) by which—

"(A) the fair market value of the assets of the S corporation as of the beginning of its 1st taxable year for which an election under section 1362(a) is in effect, exceeds

"(B) the aggregate adjusted bases of such assets at such time.

"(2) RECOGNIZED BUILT-IN GAIN.—The term 'recognized built-in gain' means any gain recognized during the recognition period on the disposition of any asset except to the extent that the S corporation establishes that—

"(A) such asset was not held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (1), or

"(B) such gain exceeds the excess (if any) of—

"(i) the fair market value of such asset as of the beginning of such 1st taxable year, over

"(ii) the adjusted basis of the asset as of such time.

"(3) RECOGNITION PERIOD.—The term 'recognition period' means the 10-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation.

"(4) TAXABLE INCOME.—Taxable income of the corporation shall be determined under section 63(a)—

"(A) without regard to the deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures), and

"(B) without regard to the deduction under section 172."

(b) TREATMENT OF DISTRIBUTIONS.—Subsection (e) of section 1363 is amended to read as follows:

"(e) SUBSECTION (d) NOT TO APPLY TO REORGANIZATIONS, ETC.—Subsection (d) shall not apply to any distribution to the extent it consists of property permitted by section 354, 355, or 356 to be received without the recognition of gain."

(c) CONFORMING AMENDMENTS.—

(1) Subparagraph (G) of section 26(b)(2) is amended by striking out "certain capital gains" and inserting in lieu thereof "certain built-in gains".

(2) Paragraph (2) of section 1366(f) is amended to read as follows:

"(2) REDUCTION IN PASS-THRU FOR TAX IMPOSED ON BUILT-IN GAINS.—If any tax is imposed under section 1374 for any taxable year on an S corporation, for purposes of subsection (a), the amount of each recognized built-in gain (as defined in section 1374(d)(2)) for such taxable year shall be reduced by its proportionate share of such tax."

(3) Subparagraph (B) of section 1375(b)(1) is amended by striking out "section 1374(d)" and inserting in lieu thereof "section 1374(d)(4)".

(d) CLERICAL AMENDMENT.—The table of sections for part III of subchapter S of chapter 1 is amended by striking out the item relating to section 1374 and inserting in lieu thereof the following:

"Sec. 1374. Tax imposed on certain built-in gains."

SEC. 633. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this subtitle shall apply to—

(1) any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless

such corporation is completely liquidated before January 1, 1987,

(2) any transaction described in section 338 of the Internal Revenue Code of 1986 for which the acquisition date occurs after December 31, 1986, and

(3) any distribution (not in complete liquidation) made after December 31, 1986.

(b) BUILT-IN GAINS OF S CORPORATIONS.—The amendments made by section 632 (other than subsection (b) thereof) shall apply to taxable years beginning after December 31, 1986, but only in cases where the 1st taxable year for which the corporation is an S corporation is pursuant to an election made after December 31, 1986.

(c) EXCEPTION FOR CERTAIN PLANS OF LIQUIDATION AND BINDING CONTRACTS.—

(1) IN GENERAL.—The amendments made by this subtitle shall not apply to—

(A) any distribution or sale or exchange made pursuant to a plan of liquidation adopted before August 1, 1986, if the liquidating corporation is completely liquidated before January 1, 1988,

(B) any distribution or sale or exchange made by any corporation if 50 percent or more of the voting stock by value of such corporation is acquired on or after August 1, 1986, pursuant to a written binding contract in effect before such date and if such corporation is completely liquidated before January 1, 1988,

(C) any distribution or sale or exchange made by any corporation if substantially all of the assets of such corporation are sold on or after August 1, 1986, pursuant to 1 or more written binding contracts in effect before such date and if such corporation is completely liquidated before January 1, 1988, or

(D) any transaction described in section 338 of the Internal Revenue Code of 1986 with respect to any target corporation if a qualified stock purchase of such target corporation is made on or after August 1, 1986, pursuant to a written binding contract in effect before such date and the acquisition date (within the meaning of such section 338) is before January 1, 1988.

(2) SPECIAL RULE FOR CERTAIN ACTIONS TAKEN BEFORE NOVEMBER 20, 1985.—For purposes of paragraph (1), transactions shall be treated as pursuant to a plan of liquidation adopted before August 1, 1986, if—

(A) before November 20, 1985—

(i) the board of directors of the liquidating corporation adopted a resolution to solicit shareholder approval for a transaction of a kind described in section 336 or 337, or

(ii) the shareholders or board of directors have approved such a transaction,

(B) before November 20, 1985—

(i) there has been an offer to purchase a majority of the voting stock of the liquidating corporation, or

(ii) the board of directors of the liquidating corporation has adopted a resolution approving an acquisition or recommending the approval of an acquisition to the shareholders, or

(C) before November 20, 1985, a ruling request was submitted to the Secretary of the Treasury or his delegate with respect to a transaction of a kind described in section 336 or 337 of the Internal Revenue Code of 1954 (as in effect before the amendments made by this subtitle).

For purposes of the preceding sentence, any action taken by the board of directors or shareholders of a corporation with respect to any subsidiary of such corporation shall be treated as taken by the board of directors or shareholders of such subsidiary.

(d) Transitional Rule for Certain Small Corporations.—

(1) In general.—In the case of the complete liquidation before January 1, 1989, of a qualified corporation, the amendments made by this section shall not apply to the applicable percentage of each gain or loss which (but for this paragraph) would be recognized by reason of the amendments made by this subtitle.

(2) Paragraph (1) not to apply to certain items.—Paragraph (1) shall not apply to—

(A) any gain or loss which is an ordinary gain or loss (determined without regard to section 1239 of the Internal Revenue Code of 1986),

(B) any gain or loss on a capital asset held for not more than 6 months, and

(C) any gain to the extent section 453B of such Code applies.

(3) Applicable percentage.—For purposes of this subsection, the term 'applicable percentage' means—

(A) 100 percent if the applicable value of the qualified corporation is less than $5,000,000, or

(B) 100 percent reduced by an amount which bears the same ratio to 100 percent as—

(i) the excess of the applicable value of the corporation over $5,000,000, bears to

(ii) $5,000,000.

(4) Applicable value.—For purposes of this subsection, the applicable value is the fair market value of all of the stock of the corporation on the date of the adoption of the plan of complete liquidation (or if greater, on August 1, 1986).

(5) Qualified corporation.—For purposes of this subsection, the term 'qualified corporation' means any corporation if—

(A) on August 1, 1986, and at all times thereafter before the corporation is completely liquidated, more than 50 percent (by value) of the stock in such corporation is held by 10 or fewer qualified persons, and

(B) the applicable value of such corporation does not exceed $10,000,000.

(6) Definitions and special rules.—For purposes of this subsection—

(A) Qualified person.—The term "qualified person" means—

(i) an individual,

(ii) an estate, or

(iii) any trust described in clause (ii) or (iii) of section 1361(c)(2)(A) of the Internal Revenue Code of 1986.

(B) ATTRIBUTION RULES.—

(i) ENTITIES.—Any stock held by a corporation, trust, or partnership shall be treated as owned proportionally by its shareholders, beneficiaries, or partners. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person.

(ii) FAMILY MEMBERS.—Stock owned (or treated as owned under clause (i)) by members of the same family (within the meaning of section 318(a)(1) of the Internal Revenue Code of 1986) shall be treated as owned by 1 person.

(C) CONTROLLED GROUP OF CORPORATIONS.—All members of the same controlled group (as defined in section 267(f)(1) of such Code) shall be treated as 1 corporation for purposes of this subsection.

(7) SECTION 338 TRANSACTIONS.—The provisions of this subsection shall also apply in the case of a transaction described in section 338 of the Internal Revenue Code of 1986 where the acquisition date (within the meaning of such section 338) is before January 1, 1989.

(8) APPLICATION OF SECTION 1374.—Rules similar to the rules of this subsection shall apply for purposes of applying section 1374 of the Internal Revenue Code of 1986 (as amended by section 632) in the case of a qualified corporation which becomes an S corporation for a taxable year beginning before January 1, 1989.

(d) COMPLETE LIQUIDATION DEFINED.—For purposes of this section, a corporation shall be treated as completely liquidated if all of the assets of such corporation are distributed in complete liquidation, less assets retained to meet claims.

(e) OTHER TRANSITIONAL RULES.—

(1) The amendments made by this subtitle shall not apply to any liquidation of a corporation incorporated under the laws of Pennsylvania on August 3, 1970, if—

(A) the board of directors of such corporation approved a plan of liquidation before January 1, 1986,

(B) an agreement for the sale of a material portion of the assets of such corporation was signed on May 9, 1986 (whether or not the assets are sold in accordance with such agreement), and

(C) the corporation is completely liquidated on or before December 31, 1988.

(2) The amendments made by this subtitle shall not apply to any liquidation (or deemed liquidation under section 338 of the Internal Revenue Code of 1986) of a diversified financial services corporation incorporated under the laws of Delaware on May 9, 1929, pursuant to a binding written contract entered into on or before December 31, 1986; but only if the liquidation

is completed (or in the case of a section 338 election, the acquisition date occurs) before January 1, 1988.

(3) The amendments made by this subtitle shall not apply to any distribution, or sale, or exchange—

(A) of the assets owned (directly or indirectly) by a testamentary trust established under the will of a decent dying on June 15, 1956, to its beneficiaries,

(B) made pursuant to a court order in an action filed on January 18, 1984, if such order—

(i) is issued after July 31, 1986, and

(ii) directs the disposition of the assets of such trust and the division of the trust corpus into 3 separate subtrusts.

For purposes of the preceding sentence, an election under section 338(g) of the Internal Revenue Code of 1986 (or an election under section 338(h)(10) of such Code), qualifying as a section 337 liquidation pursuant to regulations prescribed by the Secretary under section 1.338(h)(10)-1T(j)) made in connection with a sale or exchange pursuant to a court order described in subparagraph (B) shall be treated as a sale of exchange.

(4)(A) The amendments made by this subtitle shall not apply to any distribution, or sale, or exchange—

(i) if—

(I) an option agreement binding on the selling corporation to sell substantially all its assets is executed before August 1, 1986, the corporation adopts (by approval of its shareholders) a conditional plan of liquidation before August 1, 1986 to become effective upon the exercise of such option agreement (or modification thereto), and the assets are sold pursuant to the exercise of the option (as originally executed or subsequently modified provided that the purchase price is not thereby increased), or

(II) in the event that the optionee does not acquire substantially all the assets of the corporation, the optionor corporation sells substantially all its assets to another purchaser at a purchase price not greater than that contemplated by such option agreement pursuant to an effective plan of liquidation, and

(ii) the complete liquidation of the corporation occurs within 12 months of the time the plan of liquidation becomes effective, but in no event later than December 31, 1989.

(B) For purposes of subparagraph (A), a distribution, or sale, or exchange, of a distributee corporation (within the meaning of section 337(c)(3) of the Internal Revenue Code of 1986) shall be treated as satisfying the requirements of subparagraph (A) if its subsidiary satisfies the requirements of subparagraph (A).

(C) For purposes of section 56 of the Internal Revenue Code of 1986 (as amended by this Act), any gain or loss not recognized by reason of this paragraph shall not be taken into account in determining the adjusted net book income of the corporation.

(5) In the case of a corporation incorporated under the laws of Wisconsin on April 3, 1948—

(A) a voting trust established not later than December 31, 1987, for purposes of holding employees' shares of stock in such corporation, shall qualify as a trust permitted as a shareholder of an S corporation, and

(B) the amendment made by section 632 (other than subsection (b) thereof) shall not apply to such corporation if it elects to be an S corporation before January 1, 1989.

(6) The amendments made by this subtitle shall not apply to the liquidation of a corporation incorporated on January 26, 1982, under the laws of the State of Alabama with a principal place of business in Colbert County, Alabama, but only if such corporation is completely liquidated on or before December 31, 1987.

(7) The amendments made by this subtitle shall not apply to the acquisition by a Delaware bank holding company of all of the assets of an Iowa Bank holding company pursuant to a written contract dated December 9, 1981.

(8) The amendments made by this subtitle shall not apply to the liquidation of a corporation incorporated under the laws of Delaware on January 20, 1984, if more than 40 percent of the stock of such corporation was acquired by purchase on June 11, 1986, and there was a tender offer with respect to all additional outstanding shares of such corporation on July 29, 1986, but only if the corporation is completely liquidated on or before December 31, 1987.

(f) Treatment of Certain Distributions in Response To Hostile Tender Offer.—

(1) In general.—No gain or loss shall be recognized under the Internal Revenue Code of 1986 to a corporation (hereinafter in this subsection referred to as "parent" on a qualified distribution.

(2) Qualified Distribution Defined.—For purposes of paragraph (1)—

(A) In general.—The term "qualified distribution" means a distribution—

(i) by parent of all of the stock of a qualified subsidiary in exchange for stock of parent which was acquired for purposes of such exchange pursuant to a tender offer dated February 16, 1982, and

(ii) pursuant to a contract dated February 13, 1982, and

(iii) which was made not more than 60 days after the board of directors of parent recommended rejection of an unsolicited tender offer to obtain control of parent.

(B) Qualified subsidiary.—The term "qualified subsidiary" means a corporation created or organized under the laws of Delaware on September 7, 1976, all of the stock of which was owned by parent immediately before the qualified distribution.

SEC. 634. STUDY OF CORPORATE PROVISIONS.

The Secretary of the Treasury or his delegate shall conduct a study of proposals to reform the provisions of subchapter C of chapter 1 of the Internal Revenue Code of 1986. Not later than January

1, 1988, the Secretary shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report on the study conducted under this section (together with such recommendations as he may deem advisable).

Subtitle E—Other Corporate Provisions

SEC. 641. SPECIAL ALLOCATION RULES FOR CERTAIN ASSET ACQUISITIONS.

(a) In General.—Part IV of subchapter O of chapter 1 (relating to special rules for determining basis) is amended by redesignating section 1060 as section 1061 and by inserting after section 1059 the following new section:

"SEC. 1060. SPECIAL ALLOCATION RULES FOR CERTAIN ASSET ACQUISITIONS.

"(a) General Rule.—In the case of any applicable asset acquisition, for purposes of determining both—

"(1) the transferee's basis in such assets, and

"(2) the gain or loss of the transferor with respect to such acquisition,

the consideration received for such assets shall be allocated among such assets acquired in such acquisition in the same manner as amounts are allocated to assets under section 338(b)(5).

"(b) Information Required To Be Furnished to Secretary.—Under regulations, the transferor and transferee in an applicable asset acquisition shall, at such times and in such manner as may be provided in such regulations, furnish to the Secretary the following information:

"(1) The amount of the consideration received for the assets which is allocated to goodwill or going concern value.

"(2) Any modification of the amount described in paragraph (1).

"(3) Any other information with respect to other assets transferred in such acquisition as the Secretary may find necessary to carry out the provisions of this section.

"(c) Applicable Asset Acquisition.—For purposes of this section, the term 'applicable asset acquisition' means any transfer (whether directly or indirectly)—

"(1) of assets which constitute a trade or business, and

"(2) with respect to which the transferee's basis in such assets is determined wholly by reference to the consideration paid for such assets.

A transfer shall not be treated as failing to be an applicable asset acquisition merely because section 1031 applies to a portion of the assets transferred."

(b) Conforming Amendment.—The table of sections for part IV of subchapter O of chapter 1 is amended by striking out the item relating to section 1060 and inserting in lieu thereof the following new items:

"Sec. 1060. Special allocation rules for certain asset acquisitions.
"Sec. 1061. Cross references."

(c) Effective Date.—The amendments made by this section shall apply to any acquisition of assets after May 6, 1986, unless such ac-

quisition is pursuant to a binding contract which was in effect on May 6, 1986, and at all times thereafter.

SEC. 642. MODIFICATION OF DEFINITION OF RELATED PARTY.

(a) Definitions of Related Party for Purposes of Certain Sales.—

(1) Sale of depreciable property between certain related taxpayers.—

(A) In general.—Paragraph (1) of section 1239(b) (defining related persons) is amended by striking out "80-percent owned entities" and inserting in lieu thereof "controlled entities".

(B) Controlled entity defined.—

(i) In general.—Section 1239(c)(1) (defining 80-percent owned entity) is amended—

(I) by striking out "80-percent owned entity" and inserting in lieu thereof "controlled entity",

(II) by striking out "80 percent or more in value" in subparagraph (A) and inserting in lieu thereof "more than 50 percent of the value",

(III) by striking out "80 percent or more" in subparagraph (B) and inserting in lieu thereof "more than 50 percent", and

(IV) by striking out "and" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting ", and", and by adding at the end thereof the following new paragraph:

"(C) any entity which is a related person to such person under paragraph (3), (10), (11), or (12) of section 267(b)."

(ii) Conforming amendment.—Section 1239(c) is amended by striking out "80-Percent Owned Entity" in the heading thereof and inserting in lieu thereof "Controlled Entity",

(C) Constructive ownership.—Paragraph (2) of section 1239(c) is amended to read as follows:

"(2) Constructive ownership.—For purposes of this section, ownership shall be determined in accordance with rules similar to the rules under section 267(c) (other than paragraph (3) thereof)."

(D) Conforming amendment.—Section 453(g) is amended by striking out "80-Percent Owned" in the heading thereof and inserting in lieu thereof "Controlled".

(2) Partnerships.—Paragraph (2) of section 707(b) (relating to gains treated as ordinary income) is amended by striking out "80 percent" each place it appears and inserting in lieu thereof "50 percent".

(3) Installment sales.—Paragraph (1) of section 453(f) (defining related person) is amended to read as follows:

"(1) Related person.—Except for purposes of subsection (g) and (h), the term 'related person' means—

"(A) a person whose stock would be attributed under section 318(a) (other than paragraph (4) thereof) to the person first disposing of the property, or

"(B) a person who bears a relationship described in section 267(b) to the person first disposing of the property."

(b) Rules Relating to Contingent Payments.—

(1) Payments to be received defined.—Section 453(f) (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(8) Payments to be received defined.—The term 'payment to be received' includes—

"(A) the aggregate amount of all payments which are not contingent as to amount, and

"(B) the fair market value of any payments which are contingent as to amount."

(2) Sale of depreciable property between related parties.—Paragraph (1) of section 453(g) (relating to sale of depreciable property to controlled entities) is amended to read as follows:

"(1) In general.—In the case of an installment sale of depreciable property between related persons (within the meaning of section 1239(b))—

"(A) subsection (a) shall not apply, and

"(B) for purposes of this title—

"(i) except as provided in clause (ii), all payments to be received shall be treated as received in the year of the disposition, and

"(ii) in the case of any payments which are contingent as to amount but with respect to which the fair market value may not be reasonably ascertained—

"(I) the basis shall be recovered ratably, and

"(II) the purchaser may not increase the basis of any property acquired in such sale by any amount before such time as the seller includes such amount in income."

(c) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to sales after the date of the enactment of this Act, in taxable years ending after such date.

(2) Traditional rule for binding contracts.—The amendments made by this section shall not apply to sales made after August 14, 1986, which are made pursuant to a binding contract in effect on August 14, 1986, and at all times thereafter.

SEC. 643. TREATMENT OF AMORTIZABLE BOND PREMIUM AS INTEREST.

(a) In General.—Section 171 (relating to amortizable bond premium) is amended by redesignating subsection (e) as (f) and by inserting after subsection (d) the following new subsection:

"(e) Treatment as Interest.—Except as provided in regulations, the amount of any amortizable bond premium with respect to which a deduction is allowed under subsection (a)(1) for any taxable year shall be treated as interest for purposes of this title."

(b) Effective Date.—

(1) In general.—The amendment made by subsection (a) shall apply to obligations acquired after the date of the enactment of this Act, in taxable years ending after such date.

(2) Revocation of election.—In the case of a taxpayer with respect to whom an election is in effect on the date of enactment of this Act under section 171(c) of the Internal Revenue Code of 1986, such election shall apply to obligations issued after the date of the enactment of this Act only if the taxpayer chooses (at such time and in such manner as may be prescribed by the Secretary of the Treasury or his delegate) to have such election apply with respect to such obligations.

SEC. 644. PROVISIONS RELATING TO COOPERATIVE HOUSING CORPORATIONS.

(a) Tenant-Stockholder May Include Person Other Than Individual.—

(1) In general.—Section 216(b)(2) (defining tenant-stockholder) is amended—

(A) by striking out "an individual" and inserting in lieu thereof "a person", and

(B) by striking out "such individual" and inserting in lieu thereof "such person".

(2) Prior approval of occupancy.—Paragraphs (5) and (6) of section 216(b) are amended to read as follows:

"(5) Prior approval of occupancy.—For purposes of this section, in the following cases there shall not be taken into account the fact that (by agreement with the cooperative housing corporation) the person or his nominee may not occupy the house or apartment without the prior approval of such corporation:

"(A) In any case where a person acquires stock of a cooperative housing corporation by operation of law.

"(B) In any case where a person other than an individual acquires stock of a cooperative housing corporation.

"(C) In any case where the original seller acquires any stock of the cooperative housing corporation from the corporation not later than 1 year after the date on which the apartments or houses (or leaseholds therein) are transferred by the original seller to the corporation.

"(6) Original seller defined.—For purposes of paragraph (5), the term 'original seller' means the person from whom the corporation has acquired the apartments or houses (or leaseholds therein).".

(b) Treatment of Depreciation.—Section 216(c) (relating to treatment as property subject to depreciation) is amended to read as follows:

"(c) Treatment as Property Subject to Depreciation.—

"(1) In general.—So much of the stock of a tenant-stockholder in a cooperative housing corporation as is allocable, under regulations prescribed by the Secretary, to a proprietary lease or right of tenancy in property subject to the allowance for depreciation under section 167(a) shall, to the extent such proprietary lease or right of tenancy is used by such tenant-stockholder in a trade or business or for the production of income, be treated as property subject to the allowance for depreciation under section 167(a). The preceding sentence shall not be construed to limit or deny a deduction for depreciation under section 167(a) by a co-

operative housing corporation with respect to property owned by such a corporation and leased to tenant-stockholders.

"(2) DEDUCTION LIMITED TO ADJUSTED BASIS IN STOCK.—

"(A) IN GENERAL.—The amount of any deduction for depreciation allowable under section 167(a) to a tenant-stockholder with respect to any stock for any taxable year by reason of paragraph (1) shall not exceed the adjusted basis of such stock as of the close of the taxable year of the tenant-stockholder in which such deduction was incurred.

"(B) CARRYFORWARD OF DISALLOWED AMOUNT.—The amount of any deduction which is not allowed by reason of subparagraph (A) shall, subject to the provisions of subparagraph (A), be treated as a deduction allowable under section 167(a) in the succeeding taxable year.".

(c) DISALLOWANCE OF DEDUCTIONS FOR PAYMENTS TO CORPORATION.—Section 216 is amended by adding at the end thereof the following new subsection:

"(d) DISALLOWANCE OF DEDUCTION FOR CERTAIN PAYMENTS TO THE CORPORATION.—No deduction shall be allowed to a stockholder in a cooperative housing corporation for any amount paid or accrued to such corporation during any taxable year (in excess of the stockholder's proportionate share of the items described in subsections (a)(1) and (a)(2)) to the extent that, under regulations prescribed by the Secretary, such amount is properly allocable to amounts paid or incurred at any time by the corporation which are chargeable to the corporation's capital account. The stockholder's adjusted basis in the stock in the corporation shall be increased by the amount of such disallowance."

(d) DEDUCTION OF TAXES AND INTEREST.—Paragraph (3) of section 216(b) (defining tenant-stockholder's proportionate share) is amended to read as follows:

"(3) TENANT-STOCKHOLDER'S PROPORTIONATE SHARE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'tenant-stockholder's proportionate share' means that proportion which the stock of the cooperative housing corporation owned by the tenant-stockholder is of the total outstanding stock of the corporation (including any stock held by the corporation).

"(B) SPECIAL RULE WHERE ALLOCATION OF TAXES OR INTEREST REFLECT COST TO CORPORATION OF STOCKHOLDER'S UNIT.—

"(i) IN GENERAL.—If, for any taxable year—

"(I) each dwelling unit owned or leased by a cooperative housing corporation is separately allocated a share of such corporation's real estate taxes described in subsection (a)(1) or a share of such corporation's interest described in subsection (a)(2), and

"(II) such allocations reasonably reflect the cost to such corporation of such taxes, or of such interest, attributable to the tenant-stockholder's dwelling unit (and such unit's share of the common areas),

then the term 'tenant-stockholder's proportionate share' means the shares determined in accordance with the allocations described in subclause (II).

"(ii) ELECTION BY CORPORATION REQUIRED.—Clause (i) shall apply with respect to any cooperative housing corporation only if such corporation elects its application. Such an election, once made, may be revoked only with the consent of the Secretary."

(e) TREATMENT OF AMOUNTS RECEIVED IN CONNECTION WITH THE REFINANCING OF INDEBTEDNESS OF CERTAIN COOPERATIVE HOUSING CORPORATIONS; TREATMENT OF AMOUNTS PAID FROM QUALIFIED REFINANCING-RELATED RESERVE.—

(1) PAYMENT OF CLOSING COSTS AND CREATION OF RESERVE EXCLUDED FROM GROSS INCOME.—For purposes of the Internal Revenue Code of 1954, no amount shall be included in the gross income of a qualified cooperative housing corporation by reason of the payment or reimbursement by a city housing development agency or corporation of amounts for—

(A) closing costs, or

(B) the creation of reserves for the qualified cooperative housing corporation,

in connection with a qualified refinancing.

(2) INCOME FROM RESERVE FUND TREATED AS MEMBER INCOME.—

(A) IN GENERAL.—Income from a qualified refinancing-related reserve shall be treated as derived from its members for purposes of—

(i) section 216 of the Internal Revenue Code of 1954 (relating to deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholder), and

(ii) section 277 of such Code (relating to deductions incurred by certain membership organizations in transactions with members).

(B) NO INFERENCE.—Nothing in the provisions of this paragraph shall be construed to infer that a change in law is intended with respect to the treatment of deductions under section 277 of the Internal Revenue Code of 1954 with respect to cooperative housing corporations, and any determination of such issue shall be made as if such provisions had not been enacted.

(3) TREATMENT OF CERTAIN INTEREST CLAIMED AS DEDUCTION.—Any amount—

(A) claimed (on a return of tax imposed by chapter 1 of the Internal Revenue Code of 1954) as a deduction by a qualified cooperative housing corporation for interest for any taxable year beginning before January 1, 1986, on a second mortgage loan made by a city housing development agency or corporation in connection with a qualified refinancing, and

(B) reported (before April 16, 1986) by the qualified cooperative housing corporation to its tenant-stockholders as interest described in section 216(a)(2) of such Code,

shall be treated for purposes of such Code as if such amount were paid by such qualified cooperative housing corporation during such taxable year.

(4) QUALIFIED COOPERATIVE HOUSING CORPORATION.—

(A) IN GENERAL.—For purposes of this subsection, the term "qualified cooperative housing corporation" means any corporation if—

(i) such corporation is, after the application of paragraphs (1) and (2), a cooperative housing corporation (as defined in section 216(b) of the Internal Revenue Code of 1954),

(ii) such corporation is subject to a qualified limited-profit housing companies law, and

(iii) such corporation either—

(I) filed for incorporation on July 22, 1965, or

(II) filed for incorporation on March 5, 1964.

(B) QUALIFIED LIMITED-PROFIT HOUSING COMPANIES LAW.—For purposes of subparagraph (A), the term "qualified limited-profit housing companies law" means any limited-profit housing companies law which limits the resale price for a tenant-stockholder's stock in a cooperative housing corporation to the sum of his basis for such stock plus his proportionate share of part or all of the amortization of any mortgage on the building owned by such corporation.

(5) QUALIFIED REFINANCING.—For purposes of this subsection, the term "qualified refinancing" means any refinancing—

(A) which occurred—

(i) with respect to a qualified cooperative housing corporation described in paragraph (4)(A)(iii)(I) on September 20, 1978, or

(ii) with respect to a qualified cooperative housing corporation described in paragraph (4)(A)(iii)(II) on November 21, 1978, and

(B) in which a qualified cooperative housing corporation refinanced a first mortgage loan made to such corporation by a city housing development agency with a first mortgage loan made by a city housing development corporation and insured by an agency of the Federal Government and a second mortgage loan made by such city housing development agency, in the process of which a reserve was created (as required by such Federal agency) and closing costs were paid or reimbursed by such city housing development agency or corporation.

(6) QUALIFIED REFINANCING-RELATED RESERVE.—For purposes of this subsection, the term "qualified refinancing-related reserve" means any reserve of a qualified cooperative housing corporation with respect to the creation of which no amount was included in the gross income of such corporation by reason of paragraph (a).

(7) TREATMENT OF AMOUNTS PAID FROM QUALIFIED REFINANCING-RELATED RESERVE.—

(A) IN GENERAL.—With respect to any payment from a qualified refinancing-related reserve out of amounts excluded from gross income by reason of paragraph (1)—

(i) no deduction shall be allowed under chapter 1 of such Code, and

(ii) the basis of any property acquired with such payment (determined without regard to this subparagraph) shall be reduced by the amount of such payment.

(B) ORDERING RULES.—For purposes of subparagraph (A), payments from a reserve shall be treated as being made—

(i) first from amounts excluded from gross income by reason of paragraph (1) to the extent thereof, and

(ii) then from other amounts in the reserve.

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) SUBSECTION (e).—

(A) Except as provided in subparagraph (B), subsection (e) shall apply to taxable years beginning before January 1, 1986.

(B) Subsection (e)(7) shall apply to amounts paid or incurred, and property acquired, in taxable years beginning, after December 31, 1985.

SEC. 645. SPECIAL RULES RELATING TO PERSONAL HOLDING COMPANY TAX.

(a) COMPUTER SOFTWARE ROYALTIES.—

(1) IN GENERAL.—Paragraph (1) of section 543(a) (defining personal holding company income) is amended—

(A) by striking out "and" at the end of subparagraph (A),

(B) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", and", and

(C) by adding at the end thereof the following new subparagraph:

"(C) active business computer software royalties (within the meaning of subsection (d))."

(2) ACTIVE BUSINESS COMPUTER SOFTWARE ROYALTIES DEFINED.—Section 543 is amended by adding at the end thereof the following new subsection:

"(d) ACTIVE BUSINESS COMPUTER SOFTWARE ROYALTIES.—

"(1) IN GENERAL.—For purposes of this section, the term 'active business computer software royalties' means any royalties—

"(A) received by any corporation during the taxable year in connection with the licensing of computer software, and

"(B) with respect to which the requirements of paragraphs (2), (3), (4), and (5) are met.

"(2) ROYALTIES MUST BE RECEIVED BY CORPORATION ACTIVELY ENGAGED IN COMPUTER SOFTWARE BUSINESS.—The requirements of this paragraph are met if the royalties described in paragraph (1)—

"(A) are received by a corporation engaged in the active conduct of the trade or business of developing, manufacturing, or producing computer software, and

"(B) are attributable to computer software which—

"(i) is developed, manufactured, or produced by such corporation (or its predecessor) in connection with the trade or business described in subparagraph (A), or

"(ii) is directly related to such trade or business.

"(3) ROYALTIES MUST CONSTITUTE AT LEAST 50 PERCENT OF INCOME.—The requirements of this paragraph are met if the royalties described in paragraph (1) constitute at least 50 percent of the ordinary gross income of the corporation for the taxable year.

"(4) DEDUCTIONS UNDER SECTIONS 162 AND 174 RELATING TO ROYALTIES MUST EQUAL OR EXCEED 25 PERCENT OF ORDINARY GROSS INCOME.—

"(A) IN GENERAL.—The requirements of this paragraph are met if—

"(i) the sum of the deductions allowable to the corporation under sections 162, 174, and 195 for the taxable year which are properly allocable to the trade or business described in paragraph (2) equals or exceeds 25 percent of the ordinary gross income of such corporation for such taxable year, or

"(ii) the average of such deductions for the 5-taxable year period ending with such taxable year equals or exceeds 25 percent of the average ordinary gross income of such corporation for such period.

If a corporation has not been in existence during the 5-taxable year period described in clause (ii), then the period of existence of such corporation shall be substituted for such 5-taxable year period.

"(B) DEDUCTIONS ALLOWABLE UNDER SECTION 162.—For purposes of subparagraph (A), a deduction shall not be treated as allowable under section 162 if it is specifically allowable under another section.

"(C) LIMITATION ON ALLOWABLE DEDUCTIONS.—For purposes of subparagraph (A), no deduction shall be taken into account with respect to compensation for personal services rendered by the 5 individual shareholders holding the largest percentage (by value) of the outstanding stock of the corporation. For purposes of the preceding sentence—

"(i) individuals holding less than 5 percent (by value) of the stock of such corporation shall not be taken into account, and

"(ii) stock deemed to be owned by a shareholder solely by attribution from a partner under section 544(a)(2) shall be disregarded.

"(5) DIVIDENDS MUST EQUAL OR EXCEED EXCESS OF PERSONAL HOLDING COMPANY INCOME OVER 10 PERCENT OF ORDINARY GROSS INCOME.—

"(A) IN GENERAL.—The requirements of this paragraph are met if the sum of—

"(i) the dividends paid during the taxable year (determined under section 562),

"(ii) the dividends considered as paid on the last day of the taxable year under section 563(c) (as limited by the second sentence of section 563(b)), and

"(iii) the consent dividends for the taxable year (determined under section 565),

equals or exceeds the amount, if any, by which the personal holding company income for the taxable year exceeds 10 percent of the ordinary gross income of such corporation for such taxable year.

"(B) COMPUTATION OF PERSONAL HOLDING COMPANY INCOME.—For purposes of this paragraph, personal holding company income shall be computed—

"(i) without regard to amounts described in subsection (a)(1)(C),

"(ii) without regard to interest income during any taxable year—

"(I) which is in the 5-taxable year period beginning with the later of the 1st taxable year of the corporation or the 1st taxable year in which the corporation conducted the trade or business described in paragraph (2)(A), and

"(II) during which the corporation meets the requirements of paragraphs (2), (3), and (4), and

"(iii) by including adjusted income from rents and adjusted income from mineral, oil, and gas royalties (within the meaning of paragraphs (2) and (3) of subsection (a)).

"(6) SPECIAL RULES FOR AFFILIATED GROUP MEMBERS.—

"(A) IN GENERAL.—In any case in which—

"(i) the taxpayer receives royalties in connection with the licensing of computer software, and

"(ii) another corporation which is a member of the same affiliated group as the taxpayer meets the requirements of paragraphs (2), (3), (4), and (5) with respect to such computer software,

the taxpayer shall be treated as having met such requirements.

"(B) AFFILIATED GROUP.—For purposes of this paragraph, the term 'affiliated group' has the meaning given such term by section 1504(a)."

(3) FOREIGN PERSONAL HOLDING COMPANY INCOME.—Paragraph (1) of section 553(a) (defining foreign personal holding company income) is amended by adding at the end thereof the following new sentence: "This paragraph shall not apply to active business computer software royalties (as defined in section 543(d))."

(4) CONFORMING AMENDMENTS.—

(A) Section 543(a)(4) (relating to copyright royalties) is amended by adding at the end thereof the following new sentence: "This paragraph shall not apply to active business computer software royalties.".

(B) Section 543(b)(3) (relating to adjusted income from rents) is amended—

(i) by striking out "or" at the end of subparagraph (C),

(ii) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof ", or", and

(iii) by adding at the end thereof the following new subparagraph:

"(E) active business computer software royalties (as defined in subsection (d))."

(b) Special Rules for Broker-Dealers.—In the case of a broker-dealer which is part of an affiliated group which files a consolidated Federal income tax return, the common parent of which was incorporated in Nevada on January 27, 1972, the personal holding company income (within the meaning of section 543 of the Internal Revenue Code of 1986) of such broker-dealer, shall not include any interest received after the date of the enactment of this Act with respect to—

(1) any securities or money market instruments held as inventory,

(2) margin accounts, or

(3) any financing for a customer secured by securities or money market instruments.

(c) Special Rule for Royalties Received by Qualified Taxpayer.—

(1) In general.—Any qualified royalty received or accrued in taxable years beginning after December 31, 1981, by a qualified taxpayer shall be treated in the same manner as a royalty with respect to software is treated under the amendments made by this section.

(2) Qualified taxpayer.—For purposes of this subsection, a qualified taxpayer is any taxpayer incorporated on September 7, 1978, which is engaged in the trade or business of manufacturing dolls and accessories.

(3) Qualified royalty.—For purposes of this subsection, the term "qualified royalty" means any royalty arising from an agreement entered into in 1982 which permits the licensee to manufacture and sell dolls and accessories.

(d) Special Rule for Treatment of Active Business Computer Royalties for S Corporation Purposes.—In the case of a taxpayer which was incorporated on May 3, 1977, in California and which elected to be taxed as an S corporation for its taxpable year ending on December 31, 1985, any active business computer royalties (within the meaning of section 543(d) of the Internal Revenue Code of 1986 as added by this Act) which are received by the taxpayer in taxable years beginning after December 31, 1984, shall not be treated as passive investment income (within the meaning of section 1362(d)(3)(D)) for purposes of subchapter S of chapter 1 of such Code.

(e) Effective Date.—The amendments made by subsection (a) shall apply to royalties received before, on, and after December 31, 1986.

SEC. 646. CERTAIN ENTITIES NOT TREATED AS CORPORATIONS.

(a) General Rule.—For purposes of the Internal Revenue Code of 1986, if the entity described in subsection (b) makes an election under subsection (c), such entity shall be treated as a trust to which subpart E of part 1 of subchapter J of chapter 1 of such Code applies.

(b) Entity.—An entity is described in this subsection if—

(1) such entity was created in 1906 as a common law trust and is governed by the trust laws of the State of Minnesota,

(2) such entity receives royalties from iron ore leases, and

(3) income interests in such entity are publicly traded on a national stock exchange.

(c) ELECTION.—

(1) IN GENERAL.—An election under this subsection to have the provisions of this section apply—

(A) shall be made by the board of trustees of the entity, and

(B) shall not be valid unless accompanied by an agreement described in paragraph (2).

(2) AGREEMENT.—The agreement described in this paragraph is a written agreement signed by the board of trustees of the entity which provides that the entity will not—

(A) sell any trust property,

(B) purchase any additional trust properties, or

(C) receive any income other than—

(i) income from long-term mineral leases, or

(ii) interest or other income attributable to ordinary and necessary reserves of the entity.

(3) PERIOD FOR WHICH ELECTION IS IN EFFECT.—An election under this subsection shall be in effect during the period—

(A) beginning on the first day of the first taxable year beginning after the date of the enactment of this Act and following the taxable year in which the election is made, and

(B) ending as of the close of the taxable year preceding the taxable year in which the entity ceases to be described in subsection (b) or violates any term of the agreement under paragraph (2).

(4) MANNER OF ELECTION.—Any election under this subsection shall be made in such manner as the Secretary of the Treasury or his delegate may prescribe.

(d) SPECIAL RULES FOR TAXATION OF TRUST.—

(1) ELECTION TREATED AS A LIQUIDATION.—If an election is made under subsection (c) with respect to any entity—

(A) such entity shall be treated as having been liquidated into a trust immediately before the period described in subsection (c)(3) in a liquidation to which section 333 of the Internal Revenue Code of 1954 (as in effect before the amendments made by this Act) applies, and

(B) any person holding an interest in the property held by such entity as of such time shall be treated as a qualified electing shareholder for purposes of section 333 of such Code (as so in effect).

(2) TERMINATION OF ELECTION.—If an entity ceases to be described in subsection (b) or violates any term of the agreement described in subsection (c)(2), then the tax imposed on such entity for the taxable year in which such cessation or violation occurs shall be increased by the sum of—

(A) the amount of taxes which would have been imposed on such entity during any taxable year with respect to which an election under subsection (c) was in effect if such election had not been in effect, plus

(B) interest determined for the period—

(i) beginning on the due date for any such taxable year, and

(ii) ending on the due date for the taxable year in which such cessation or violation occurs,

by using the rates and method applicable under section 6621 for underpayments of tax for such period.

(3) Trust ceasing to exist.—Paragraph (2) shall not apply if the trust ceases to be described in subsection (b) or violates the agreement in subsection (c)(2) because the trust ceases to exist or by reason of subsection (e).

(e) Termination of Election.—Any election under subsection (c) shall not apply to any taxable year beginning more than 5 years after the date of the enactment of this Act unless the trust petitions a court of competent jurisdiction and the court acts to remove from the trust instrument any powers deemed by the court to be inconsistent with the operation of the entity as a trust for tax purposes (as described in an Internal Revenue Service ruling dated November 1, 1983).

SEC. 647. SPECIAL RULE FOR DISPOSITION OF STOCK OF SUBSIDIARY.

If for a taxable year of an affiliated group filing a consolidated return ending on or before December 31, 1987, there is a disposition of stock of a subsidiary (within the meaning of Treasury Regulation section 1.1502–19), the amount required to be included in income with respect to such disposition under Treasury Regulation section 1.1502–19(a) shall, notwithstanding such section, be included in income ratably over the 15-year period beginning with the taxable year in which the disposition occurs. The preceding sentence shall apply only if such subsidiary was incorporated on December 24, 1969, and is a participant in a mineral joint venture with a corporation organized under the laws of the foreign country in which the joint venture mineral project is located.

Subtitle F—Regulated Investment Companies

SEC. 651. EXCISE TAX ON UNDISTRIBUTED INCOME OF REGULATED INVESTMENT COMPANIES.

(a) General Rule.—Chapter 44 (relating to real estate investment trusts) is amended by adding at the end thereof the following new section:

"SEC. 4982. EXCISE TAX ON UNDISTRIBUTED INCOME OF REGULATED INVESTMENT COMPANIES.

"(a) Imposition of Tax.—There is hereby imposed a tax on every regulated investment company for each calendar year equal to 4 percent of the excess (if any) of—

"(1) the required distribution for such calendar year, over

"(2) the distributed amount for such calendar year.

"(b) Required Distribution.—For purposes of this section—

"(1) In general.—The term 'required distribution' means, with respect to any calendar year, the sum of—

"(A) 97 percent of the regulated investment company's ordinary income for such calendar year, plus

"(B) 90 percent of the regulated investment company's capital gain net income for the 1-year period ending on October 31 of such calendar year.

"(2) Increase by prior year shortfall.—The amount determined under paragraph (1) for any calendar year shall be increased by the excess (if any) of—

"(A) the grossed up required distribution for the preceding calendar year, over

"(B) the distributed amount for such preceding calendar year.

"(3) Grossed up required distribution.—The grossed up required distribution for any calendar year is the required distribution for such year determined—

"(A) with the application of paragraph (2) to such taxable year, and

"(B) by substituting '100 percent' for each percentage set forth in paragraph (1).

"(c) Distributed Amount.—For purposes of this section—

"(1) In general.—The term 'distributed amount' means, with respect to any calendar year, the sum of—

"(A) the deduction for dividends paid (as defined in section 561) during such calendar year, and

"(B) any amount on which tax is imposed under subsection (b)(1) or (b)(3)(A) of section 852 for any taxable year ending in such calendar year.

"(2) Increase by prior year overdistribution.—The amount determined under paragraph (1) for any calendar year shall be increased by the excess (if any) of—

"(A) the distributed amount for the preceding calendar year (determined with the application of this paragraph to such preceding calendar year), over

"(B) the grossed up required distribution for such preceding calendar year.

"(3) Determination of dividends paid.—The amount of the dividends paid during any calendar year shall be determined without regard to—

"(A) the provisions of section 855, and

"(B) any exempt-interest dividend as defined in section 852(b)(5).

"(d) Time for Payment of Tax.—The tax imposed by this section for any calendar year shall be paid on or before March 15 of the following calendar year.

"(e) Definitions and Special Rules.—For purposes of this section—

"(1) Ordinary income.—The term 'ordinary income' means the investment company taxable income (as defined in section 852(b)(2)) determined—

"(A) without regard to subparagraphs (A) and (D) of section 852(b)(2),

"(B) by not taking into account any gain or loss from the sale or exchange of a capital asset, and

"(C) by treating the calendar year as the company's taxable year.

"(2) CAPITAL GAIN NET INCOME.—The term 'capital gain net income' has the meaning given to such term by section 1222(9) (determined by treating the 1-year period ending on October 31 of any calendar year as the company's taxable year).

"(3) TREATMENT OF DEFICIENCY DISTRIBUTIONS.—In the case of any deficiency dividend (as defined in section 860(f))—

"(A) such dividend shall be taken into account when paid without regard to section 860, and

"(B) any income giving rise to the adjustment shall be treated as arising when the dividend is paid.

"(4) ELECTION TO USE TAXABLE YEAR IN CERTAIN CASES.—

"(A) IN GENERAL.—If—

"(i) the taxable year of the regulated investment company ends with the month of November or December, and

"(ii) such company makes an election under this paragraph,

subsection (b)(1)(B) and paragraph (2) of this subsection shall be applied by taking into account the company's taxable year in lieu of the 1-year period ending on October 31 of the calendar year.

"(B) ELECTION REVOCABLE ONLY WITH CONSENT.—An election under this paragraph, once made, may be revoked only with the consent of the Secretary."

(b) RELATED AMENDMENTS.—

(1) TIME CERTAIN DIVIDENDS TAKEN INTO ACCOUNT.—

(A) Subsection (b) of section 852 (relating to method of taxation of regulated investment companies and their shareholders) is amended by adding at the end thereof the following new paragraph:

"(6) TIME CERTAIN DIVIDENDS TAKEN INTO ACCOUNT.—For purposes of this title, any dividend declared by a regulated investment company in December of any calendar year and payable to shareholders of record on a specified date in such month shall be deemed—

"(A) to have been received by each shareholder on such date, and

"(B) to have been paid by such company on such date (or, if earlier, as provided in section 855).

The preceding sentence shall apply only if such dividend is actually paid by the company before February 1 of the following calendar year."

(B) Subsection (b) of section 855 is amended by striking out "Amounts" and inserting in lieu thereof "Except as provided in section 852(b)(6), amounts".

(2) TREATMENT OF EARNINGS AND PROFITS.—Subsection (c) of section 852 is amended to read as follows:

"(c) EARNINGS AND PROFITS.—

"(1) IN GENERAL.—The earnings and profits of a regulated investment company for any taxable year (but not its accumulated earnings and profits) shall not be reduced by any amount which is not allowable as a deduction in computing its taxable income for such taxable year. For purposes of this subsection, the term 'regulated investment company' includes a domestic corporation

which is a regulated investment company determined without regard to the requirements of subsection (a).

"(2) COORDINATION WITH TAX ON UNDISTRIBUTED INCOME.—A regulated investment company shall be treated as having sufficient earnings and profits to treat as a dividend any distribution (other than in a redemption to which section 302(a) applies) which is treated as a dividend by such company. The preceding sentence shall not apply to the extent that the amount distributed during any calendar year by the company exceeds the required distribution for such calendar year (as determined under section 4982)."

(3) TREATMENT OF NET CAPITAL LOSS AFTER OCTOBER 31 OF ANY YEAR.—Subparagraph (C) of section 852(b)(3) (defining capital gain dividend) is amended by adding at the end thereof the following new sentences: "For purposes of this subparagraph, the amount of the net capital gain for a taxable year (to which an election under section 4982(e)(4) does not apply) shall be determined without regard to any net capital loss attributable to transactions after October 31 of such year, and any such net capital loss shall be treated as arising on the 1st day of the next taxable year. To the extent provided in regulations, the preceding sentence shall apply also for purposes of computing regulated investment company taxable income."

(c) CLERICAL AMENDMENT.—Chapter 44 is amended by striking out the chapter heading and the table of sections and inserting in lieu thereof the following:

"CHAPTER 44—QUALIFIED INVESTMENT ENTITIES

"Sec. 4981. Excise tax on undistributed income of real estate investment trusts.
"Sec. 4982. Excise tax on undistributed income of regulated investment companies."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to calendar years beginning after December 31, 1986.

SEC. 652. TREATMENT OF BUSINESS DEVELOPMENT COMPANIES.

(a) GENERAL RULE.—Paragraph (1) of section 851(a) is amended by striking out "either as a management company or as a unit investment trust" and inserting in lieu thereof "as a management company, business development company, or unit investment trust".

(b) TECHNICAL AMENDMENT.—Paragraph (1) of section 851(e) (relating to investment companies furnishing capital to development corporations) is amended by striking out "registered management company" and inserting in lieu thereof "registered management company or registered business development company".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 653. AMENDMENTS TO QUALIFICATION RULES.

(a) TREATMENT OF CERTAIN HEDGING TRANSACTIONS.—Section 851 (defining regulated investment company) is amended by adding at the end thereof the following new subsection:

"(g) TREATMENT OF CERTAIN HEDGING TRANSACTIONS.—

"(1) In general.—In the case of any designated hedge, for purposes of subsection (b)(3), increases (and decreases) during the period of the hedge in the value of positions which are part of such hedge shall be netted.

"(2) Designated hedge.—For purposes of this subsection, there is a designated hedge where—

"(A) the taxpayer's risk of loss with respect to any position in property is reduced by reason of—

"(i) the taxpayer having an option to sell, being under a contractual option to sell, or having made (and not closed) a short sale of substantially identical property,

"(ii) the taxpayer being the grantor of an option to buy substantially identical property, or

"(iii) under regulations prescribed by the Secretary, the taxpayer holding 1 or more other positions, and

"(B) the positions which are part of the hedge are clearly identified by the taxpayer in the manner prescribed by regulations."

(b) Definition of Qualifying Income.—Paragraph (2) of subsection 851(b) is amended by striking out the semicolon at the end thereof and inserting in lieu thereof: "(as defined in section 2(a)(36) of the Investment Company Act of 1940, as amended) or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies;".

(c) Foreign Currency Gains.—Subsection (b) of section 851 is amended by inserting before the last sentence thereof the following new sentence: "For purposes of paragraph (2), the Secretary may by regulation exclude from qualifying income foreign currency gains which are not ancillary to the company's principal business of investing in stock or securities (or options and futures with respect to stock or securities)."

(d) Effective Date.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 654. TREATMENT OF SERIES FUNDS AS SEPARATE CORPORATIONS.

(a) General Rule.—Section 851 is amended by adding at the end thereof the following new subsection:

"(q) Special Rule for Series Funds.—

"(1) In general.—In the case of a regulated investment company (within the meaning of subsection (a)) having more than one fund, each fund of such regulated investment company shall be treated as a separate corporation for purposes of this title (except with respect to the definitional requirement of subsection (a)).

"(2) Fund defined.—For purposes of paragraph (1) the term 'fund' means a segregated portfolio of assets, the beneficial interests in which are owned by the holders of a class or series of stock of the regulated investment company that is preferred over all other classes or series in respect of such portfolio of assets."

(b) Effective Date.—

(1) In general.—The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

(2) Treatment of certain existing series funds.—In the case of a regulated investment company which has more than one fund on the date of the enactment of this act, and has before such date been treated for Federal income tax purposes as a single corporation—

(A) the amendment made by subsection (a), and the resulting treatment of each fund as a separate corporation, shall not give rise to the realization or recognition of income or loss by such regulated investment company, its funds, or its shareholders, and

(B) the tax attributes of such regulated investment company shall be appropriately allocated among its funds.

SEC. 655. EXTENSION OF PERIOD FOR MAILING NOTICES TO SHAREHOLDERS.

(a) General Rule.—The following provisions are each amended by striking out "45 days" each place it appears and inserting in lieu thereof "60 days":

(1) Paragraph (3) of subsection 852(b).

(2) Subparagraph (A) of paragraph 852(b)(5).

(3) Subsection (c) of section 853.

(4) Paragraph (2) of subsection 854(b).

(5) Subsection (c) of section 855.

(b) Effective Date.—The amendments made by subsection (a) shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 656. PROTECTION OF MUTUAL FUNDS RECEIVING THIRD-PARTY SUMMONSES.

(a) General Rule.—Paragraph (3) of subsection 7609(a) is amended—

(1) by striking out "and" at the end of subparagraph (F);

(2) by striking out the period at the end of subparagraph (G) and inserting in lieu thereof "; and"; and

(3) by adding the following new subparagraph:

"(H) any regulated investment company (as defined in section 851) and any agent of such regulated investment company when acting as an agent thereof."

(b) Effective Date.—The amendment made by subsection (a) shall apply to summonses served after the date of the enactment of this Act.

SEC. 657. CERTAIN DISTRIBUTIONS NOT TREATED AS PREFERENTIAL DIVIDENDS.

(a) General Rule.—Subsection (c) of section 562 (relating to preferential dividends) is amended by adding at the end thereof the following new sentence: "In the case of a distribution by a regulated investment company to a shareholder who made an initial investment of at least $10,000,000 in such company, such distribution shall not be treated as not being pro rata or as being preferential solely by reason of an increase in the distribution by reason of reductions in administrative expenses of the company."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to distributions after the date of the enactment of this Act.

Subtitle G—Real Estate Investment Trusts

SEC. 661. GENERAL QUALIFICATION REQUIREMENTS.

(a) MODIFICATION OF CLOSELY-HELD REQUIREMENTS.—

(1) Paragraph (6) of section 856(a) is amended to read as follows:

"(6) which is not closely held (as determined under subsection (h)); and".

(2) Section 856 is amended by adding at the end thereof the following new subsection:

"(h) CLOSELY HELD DETERMINATIONS.—

"(1) SECTION 542(a)(2) APPLIED.—

"(A) IN GENERAL.—For purposes of subsection (a)(6), a corporation, trust, or association is closely held if the stock ownership requirement of section 542(a)(2) is met.

"(B) WAIVER OF PARTNERSHIP ATTRIBUTION, ETC.—For purposes of subparagraph (A)—

"(i) paragraph (2) of section 544(a) shall be applied as if such paragraph did not contain the phrase 'or by or for his partner', and

"(ii) sections 544(a)(4)(A) and 544(b)(1) shall be applied by substituting 'the entity meet the stock ownership requirement of section 542(a)(2)' for 'the corporation a personal holding company'.

"(2) SUBSECTIONS (a) (5) AND (6) NOT TO APPLY TO 1ST YEAR.—Paragraphs (5) and (6) of subsection (a) shall not apply to the 1st taxable year for which an election is made under subsection (c)(1) by any corporation, trust, or association."

(b) REQUIREMENT OF NO EARNINGS AND PROFITS ACCUMULATED IN NON-REIT YEARS.—Subsection (a) of section 857 is amended by striking out "and" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof ", and", and by adding at the end thereof the following:

"(3) either—

"(A) the provisions of this part apply to the real estate investment trust for all taxable years beginning after February 28, 1986, or

"(B) as of the close of the taxable year, the real estate investment trust has no earnings and profits accumulated in any non-REIT year.

For purposes of the preceding sentence, the term 'non-REIT year' means any taxable year to which the provisions of this part did not apply with respect to the entity."

(c) INITIAL CHANGE IN ANNUAL ACCOUNTING PERIOD PERMITTED.—

(1) Section 859 is amended by adding at the end thereof the following new subsection:

"(b) CHANGE OF ACCOUNTING PERIOD WITHOUT APPROVAL.—Notwithstanding section 442, an entity which has not engaged in any *active trade or business may change its accounting period to a calendar year without the approval of the Secretary if such change is in connection with an election under section 856(c).”*

(2) Section 859 is amended by striking out “For purposes of” and inserting in lieu thereof “(a) GENERAL RULE.—For purposes of”.

SEC. 662. ASSET AND INCOME REQUIREMENTS.

(a) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—Section 856 (defining real estate investment trust) is amended by adding at the end thereof the following new subsection:

“(i) TREATMENT OF CERTAIN WHOLLY OWNED SUBSIDIARIES.—

“(1) IN GENERAL.—For purposes of this title—

“(A) a corporation which is a qualified REIT subsidiary shall not be treated as a separate corporation, and

“(B) all assets, liabilities, and items of income, deduction, and credit of a qualified REIT subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the real estate investment trust.

“(2) QUALIFIED REIT SUBSIDIARY.—For purposes of this subsection, the term ‘qualified REIT subsidiary’ means any corporation if 100 percent of the stock of such corporation is held by the real estate investment trust at all times during the period such corporation was in existence.

“(3) TREATMENT OF TERMINATION OF QUALIFIED SUBSIDIARY STATUS.—For purposes of this subtitle, if any corporation which was a qualified REIT subsidiary ceases to meet the requirements of paragraph (2), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the real estate investment trust in exchange for its stock.”

(b) TEMPORARY INVESTMENT OF NEW EQUITY CAPITAL.—

(1) Paragraph (3) of section 856(c) is amended by striking out “and” at the end of subparagraph (G), by adding “and” at the end of subparagraph (H), and by inserting after subparagraph (H) the following new subparagraph:

“(I) qualified temporary investment income;”.

(2) Subparagraph (B) of section 856(c)(6) is amended by adding at the end thereof the following new sentence: “Such term also includes any property (not otherwise a real estate asset) attributable to the temporary investment of new capital, but only if such property is stock or a debt instrument, and only for the 1-year period beginning on the date the real estate trust receives such capital.”

(3) Paragraph (6) of section 856(c) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

“(D) QUALIFIED TEMPORARY INVESTMENT INCOME.—

“(i) IN GENERAL.—The term ‘qualified temporary investment income’ means any income which—

“(I) is attributable to stock or a debt instrument,

“(II) is attributable to the temporary investment of new capital, and

"(III) is received or accrued during the 1-year period beginning on the date on which the real estate investment trust receives such capital.

"(ii) NEW CAPITAL.—The term 'new capital' means any amount received by the real estate investment trust—

"(I) in exchange for stock in such trust (other than amounts received pursuant to a dividend reinvestment plan), or

"(II) in a public offering of debt obligations of such trust which have maturities of at least 5 years."

(c) TREATMENT OF SHARED APPRECIATION MORTGAGES.—Section 856 is amended by adding at the end thereof the following new subsection:

"(j) TREATMENT OF SHARED APPRECIATION MORTGAGES.—

"(1) IN GENERAL.—Solely for purposes of subsection (c) of this section and section 857(b)(6), any income derived from a shared appreciation provision shall be treated as gain recognized on the sale of the secured property.

"(2) TREATMENT OF INCOME.—For purposes of applying subsection (c) of this section and section 857(b)(6) to any income described in paragraph (1)—

"(A) the real estate investment trust shall be treated as holding the secured property for the period during which it held the shared appreciation provision (or, if shorter, for the period during which the secured property was held by the person holding such property), and

"(B) the secured property shall be treated as property described in section 1221(1) if it is so described in the hands of the person holding the secured property (or it would be so described if held by the real estate investment trust).

"(3) COORDINATION WITH PROHIBITED TRANSACTIONS SAFE HARBOR.—For purposes of section 857(b)(6)(C)—

"(A) the real estate investment trust shall be treated as having sold the secured property when it recognizes any income described in paragraph (1), and

"(B) any expenditures made by any holder of the secured property shall be treated as made by the real estate investment trust.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) SHARED APPRECIATION PROVISION.—The term 'shared appreciation provision' means any provision—

"(i) which is in connection with an obligation which is held by the real estate investment trust and is secured by an interest in real property, and

"(ii) which entitles the real estate investment trust to receive a specified portion of any gain realized on the sale or exchange of such real property (or of any gain which would be realized if the property were sold on a specified date).

"(B) SECURED PROPERTY.—The term 'secured property' means the real property referred to in subparagraph (A)."

SEC. 663. DEFINITION OF RENTS.

(a) Modification of Independent Contractor Requirements.—Paragraph (2) of section 856(d) (relating to certain amounts excluded from rents from real property) is amended by adding at the end thereof the following:

> *"Subparagraph (C) shall not apply with respect to any amount if such amount would be excluded from unrelated business taxable income under section 512(b)(3) if received by an organization described in section 511(a)(2)."*

(b) Certain Rents or Interest Based on Net Income or Profits Permitted.—

(1) Rents.—Subsection (d) of section 856 is amended by adding at the end thereof the following new paragraph:

"(6) Special rule for certain property subleased by tenant of real estate investment trusts.—

"(A) In general.—If—

"(i) a real estate investment trust receives or accrues, with respect to real or personal property, amounts from a tenant which derives substantially all of its income with respect to such property from the subleasing of substantially all of such property, and

"(ii) such tenant receives or accrues, directly or indirectly, from subtenants only amounts which are qualified rents,

then the amounts that the trust receives or accrues from the tenant shall not be excluded from the term 'rents from real property' solely by reason of being based on the income or profits of such tenant.

"(B) Qualified rents.—For purposes of subparagraph (A), the term 'qualified rents' means any amount which would be treated as rents from real property if received by the real estate investment trust."

(2) Interest.—Subsection (f) of section 856 (relating to qualifying interest income) is amended to read as follows:

"(f) Interest.—

"(1) In general.—For purposes of paragraphs (2)(B) and (3)(B) of subsection (c), the term 'interest' does not include any amount received or accrued (directly or indirectly) if the determination of such amount depends (in whole or in part) on the income or profits of any person, except that—

"(A) any amount so received or accrued shall not be excluded from the term 'interest' solely by reason of being based on a fixed percentage or percentages of receipts or sales, and

"(B) any amount so received or accrued with respect to an obligation secured by a mortgage on real property or an interest in real property shall not be excluded from the term 'interest' solely by reason of being based on the income or profits of the debtor from such property, if—

"(i) the debtor derives substantially all of its gross income with respect to such property from the leasing of substantially all of its interests in such property to tenants, and

"(ii) the amounts received or accrued directly or indirectly by the debtor from such tenants are only qualified rents (as defined in subsection (d)(6)(B)).

"(2) Special rule.—Where a real estate investment trust receives or accrues any amount which would be excluded from the term 'interest' solely because the debtor of the real estate investment trust receives or accrues any amount the determination of which depends (in whole or in part) on the income or profits of any person, only a proportionate part (determined under regulations prescribed by the Secretary) of the amount received or accrued by the real estate investment trust shall be excluded from the term 'interest'."

(3) Conforming amendment.—Subparagraph (A) of section 856(d)(2) is amended by striking out "paragraph (4)" and inserting in lieu thereof "paragraphs (4) and (6)".

SEC. 664. DISTRIBUTION REQUIREMENTS.

(a) Exclusion of Certain Noncash Income From Distribution Requirement.—Subparagraph (B) of section 857(a)(1) (relating to distribution requirements) is amended to read as follows:

"(B) any excess noncash income (as determined under subsection (e)); and"

(b) Excess Noncash Income Defined.—Section 857 is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) Excess Noncash Income.—

"(1) In general.—For purposes of subsection (a)(1)(B), the term 'excess noncash income' means the excess (if any) of—

"(A) the amount determined under paragraph (2) for the taxable year, over

"(B) 5 percent of the real estate investment trust taxable income for the taxable year determined without regard to the deduction for dividends paid (as defined in section 561) and by excluding any net capital gain.

"(2) Determination of amount.—The amount determined under this paragraph for the taxable year is the sum of—

"(A) the amount (if any) by which—

"(i) the amounts includible in gross income under section 467 (relating to certain payments for the use of property or services), exceed

"(ii) the amounts which would have been includible in gross income without regard to such section,

"(B) in the case of a real estate investment trust using the cash receipts and disbursements method of accounting, the amount (if any) by which—

"(i) the amounts includible in gross income as original issue discount on instruments to which section 1274 (relating to certain debt instruments issued for property) applies, exceed

"(ii) the amount of money and the fair market value of other property received during the taxable year under such instruments; plus

"(C) any income on the disposition of a real estate asset if—

"(i) there is a determination (as defined in section 860(e)) that such income is not eligible for nonrecognition under section 1031, and

"(ii) failure to meet the requirements of section 1031 was due to reasonable cause and not to willful neglect."

SEC. 665. TREATMENT OF CAPITAL GAINS.

(a) Coordination of Net Operating Loss Deduction With Payment of Capital Gain Dividends.—

(1) In general.—Paragraph (3) of section 857(b) (relating to capital gains) is amended by adding at the end thereof the following new subparagraph:

"(D) Coordination with net operating loss provisions.—For purposes of section 172, if a real estate investment trust pays capital gain dividends during any taxable year, the amount of the net capital gain for such taxable year (to the extent such gain does not exceed the amount of such capital gain dividends) shall be excluded in determining—

"(i) the net operating loss for the taxable year, and

"(ii) the amount of the net operating loss of any prior taxable year which may be carried through such taxable year under section 172(b)(2) to a succeeding taxable year."

(2) Repeal of limitation of net capital gain to real estate investment trust taxable income.—Subparagraph (C) of section 857(b)(3) (defining capital gain dividend) is amended by striking out the last sentence.

(b) Notice of Capital Gains Dividends May Be Mailed With Annual Report.—

(1) Subparagraph (C) of section 857(b)(3) (defining capital gain dividend) is amended by striking out "the close of its taxable year" and inserting in lieu thereof "the close of its taxable year (or mailed to its shareholders or holders of beneficial interests with its annual report for the taxable year)".

(2) Subsection (c) of section 858 (relating to notice to shareholders) is amended by striking out "distribution is made" and inserting in lieu thereof "distribution is made (or mailed to its shareholders or holders of beneficial interests with its annual report for the taxable year)".

SEC. 666. MODIFICATIONS OF PROHIBITED TRANSACTION RULES.

(a) Exemptions From Prohibited Transactions Rules.—

(1) Clause (iii) of section 857(b)(6)(C) (relating to certain sales not to constitute prohibited transactions) is amended to read as follows:

"(iii)(I) during the taxable year the trust does not make more than 7 sales of property (other than foreclosure property), or (II) the aggregate adjusted bases (as determined for purposes of computing earnings and profits) of property (other than foreclosure property) sold during the taxable year does not exceed 10 percent of the aggregate bases (as so determined) of all of the

assets of the trust as of the beginning of the taxable year; and".

(2) Clause (ii) of section 857(b)(6)(C) is amended by striking out "20 percent" and inserting in lieu thereof "30 percent".

(3) Subparagraph (C) of section 857(b)(6) is amended by striking out "and" at the end of clause (iii), by striking out the period at the end of clause (iv) and inserting in lieu thereof "; and", and by inserting after clause (iv) the following new clause:

> *"(v) if the requirement of clause (iii)(I) is not satisfied, substantially all of the marketing and development expenditures with respect to the property were made through an independent contractor (as defined in section 856(d)(3)) from whom the trust itself does not derive or receive any income."*

(b) NET LOSS FROM PROHIBITED TRANSACTIONS.—

(1) LOSS FROM PROHIBITED TRANSACTIONS NOT ALLOWED TO OFFSET GAIN FROM SUCH TRANSACTIONS.—Clause (ii) of section 857(b)(6)(B) (relating to income from prohibited transactions) is amended to read as follows:

> *"(ii) in determining the amount of the net income derived from prohibited transactions, there shall not be taken into account any item attributable to any prohibited transaction for which there was a loss; and".*

(2) NET LOSS MAY REDUCE TAXABLE INCOME.—Subparagraph (F) of section 857(b)(2) (defining real estate investment trust taxable income) is amended by striking out "and there shall be included an amount equal to any net loss derived from prohibited transactions".

SEC. 667. DEFICIENCY DIVIDENDS OF REAL ESTATE INVESTMENT TRUSTS NOT SUBJECT TO PENALTY UNDER SECTION 6697.

(a) GENERAL RULE.—The section heading and subsection (a) of section 6697 (relating to assessable penalties with respect to liability for tax of qualified investment entities) are amended to read as follows:

"SEC. 6697. ASSESSABLE PENALTIES WITH RESPECT TO LIABILITY FOR TAX OF REGULATED INVESTMENT COMPANIES.

"(a) CIVIL PENALTY.—In addition to any other penalty provided by law, any regulated investment company whose tax liability for any taxable year is deemed to be increased pursuant to section 860(c)(1)(A) shall pay a penalty in an amount equal to the amount of the interest (for which such company is liable) which is attributable solely to such increase."

(b) CONFORMING AMENDMENT.—

(1) Subsection (j) of section 860 is amended by striking out "qualified investment entity" and inserting in lieu thereof "regulated investment company".

(2) The table of sections for subchapter B of chapter 68 is amended by striking out the item relating to section 6697 and inserting in lieu thereof the following:

> *"Sec. 6697. Assessable penalties with respect to liability for tax of regulated investment companies."*

SEC. 668. EXCISE TAX ON UNDISTRIBUTED INCOME OF REAL ESTATE INVESTMENT TRUSTS.

(a) General Rule.—Section 4981 is amended to read as follows:

"SEC. 4981. EXCISE TAX ON UNDISTRIBUTED INCOME OF REAL ESTATE INVESTMENT TRUSTS.

"(a) Imposition of Tax.—There is hereby imposed a tax on every real estate investment trust for each calendar year equal to 4 percent of the excess (if any) of—

"(1) the required distribution for such calendar year, over

"(2) the distributed amount for such calendar year.

"(b) Required Distribution.—For purposes of this section—

"(1) In general.—The term 'required distribution' means, with respect to any calendar year, the sum of—

"(A) 85 percent of the real estate investment trust's ordinary income for such calendar year, plus

"(B) 95 percent of the real estate investment trust's capital gain net income for such calendar year.

"(2) Increase by prior year shortfall.—The amount determined under paragraph (1) for any calendar year shall be increased by the excess (if any) of—

"(A) the grossed up required distribution for the preceding calendar year, over

"(B) the distributed amount for such preceding calendar year.

"(3) Grossed up required distribution.—The grossed up required distribution for any calendar year is the required distribution for such year determined—

"(A) with the application of paragraph (2) to such taxable year, and

"(B) by substituting '100 percent' for each percentage set forth in paragraph (1).

"(c) Distributed Amount.—For purposes of this section—

"(1) In general.—The term 'distributed amount' means, with respect to any calendar year, the sum of—

"(A) the deduction for dividends paid (as defined in section 561) during such calendar year, and

"(B) any amount on which tax is imposed under subsection (b)(1) or (b)(3)(A) of section 857 for any taxable year ending in such calendar year.

"(2) Increase by prior year overdistribution.—The amount determined under paragraph (1) for any calendar year shall be increased by the excess (if any) of—

"(A) the distributed amount for the preceding calendar year (determined with the application of this paragraph to such preceding calendar year), over

"(B) the grossed up required distribution for such preceding calendar year.

"(3) Determination of dividends paid.—The amount of the dividends paid during any calendar year shall be determined without regard to the provisions of section 858.

"(d) Time for Payment of Tax.—The tax imposed by this section for any calendar year shall be paid on or before March 15 of the following calendar year.

“(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this sec-ion—

“(1) ORDINARY INCOME.—The term ‘ordinary income’ means the real estate investment trust taxable income (as defined in section 857(b)(2)) determined—

“(A) without regard to subparagraph (B) of section 857(b)(2),

“(B) by not taking into account any gain or loss from the sale or exchange of a capital asset, and

“(C) by treating the calendar year as the trust’s taxable year.

“(2) CAPITAL GAIN NET INCOME.—The term ‘capital gain net income’ has the meaning given to such term by section 1222(9) (determined by treating the calendar year as the trust’s taxable year).

“(3) TREATMENT OF DEFICIENCY DISTRIBUTIONS.—In the case of any deficiency dividend (as defined in section 860(f))—

“(A) such dividend shall be taken into account when paid without regard to section 860, and

“(B) any income giving rise to the adjustment shall be treated as arising when the dividend is paid.”

(b) RELATED AMENDMENTS.—

(1) TIME CERTAIN DIVIDENDS TAKEN INTO ACCOUNT.—

(A) Subsection (b) of section 857 (relating to method of taxation of real estate investment trusts and holders of interests therein) is amended by adding at the end thereof the following new paragraph:

“(8) TIME CERTAIN DIVIDENDS TAKEN INTO ACCOUNT.—For purposes of this title, any dividend declared by a real estate investment trust in December of any calendar year and payable to shareholders of record on a specified date in such month shall be deemed—

“(A) to have been received by each shareholder on such date, and

“(B) to have been paid by such trust on such date (or, if earlier, as provided in section 858).

The preceding sentence shall apply only if such dividend is actually paid by the company before February 1 of the following calendar year.”

(B) Subsection (b) of section 856 is amended by striking out “Amounts” and inserting in lieu thereof “Except as provided in section 857(b)(8), amounts”.

(2) TREATMENT OF EARNINGS AND PROFITS.—Subsection (d) of section 857 is amended to read as follows:

“(d) EARNINGS AND PROFITS.—

“(1) IN GENERAL.—The earnings and profits of a real estate investment trust for any taxable year (but not its accumulated earnings) shall not be reduced by any amount which is not allowable in computing its taxable income for such taxable year. For purposes of this subsection, the term ‘real estate investment trust’ includes a domestic corporation, trust, or association which is a real estate investment trust determined without regard to the requirements of subsection (a).

"(2) COORDINATION WITH TAX ON UNDISTRIBUTED INCOME.—A real estate investment trust shall be treated as having sufficient earnings and profits to treat as a dividend any distribution (other than in a redemption to which section 302(a) applies) which is treated as a dividend by such trust. The preceding sentence shall not apply to the extent that the amount distributed during any calendar year by the trust exceeds the required distribution for such calendar year (as determined under section 4981)."

(3) TREATMENT OF NET CAPITAL GAIN AFTER OCTOBER 31 OF ANY YEAR.—Subparagraph (C) of section 857(b)(3) (defining capital gain dividend) is amended by adding at the end thereof the following new sentences: "For purposes of this subparagraph, the amount of the net capital gain for any taxable year which is not a calendar year shall be determined without regard to any net capital loss attributable to transactions after December 31 of such year, and any such net capital loss such be treated as arising on the 1st day of the next taxable year. To the extent provided in regulations, the preceding sentence shall apply also for purposes of computing real estate investment trust taxable income."

SEC. 669. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this part shall apply to taxable years beginning after December 31, 1986.

(b) SECTION 668.—The amendments made by section 668 shall apply to calendar years beginning after December 31, 1986.

(c) RETENTION OF EXISTING TRANSITIONAL RULE.—The amendment made by section 663(b)(2) shall not apply with respect to amounts received or accrued pursuant to loans made before May 28, 1976. For purposes of the preceding sentence, a loan is considered to be made before May 28, 1976, if such loan is made pursuant to a binding commitment entered into before May 28, 1976.

Subtitle H—Taxation of Interests in Entities Holding Real Estate Mortgages

SEC. 671. TAXATION OF REAL ESTATE MORTGAGE INVESTMENT CONDUITS.

(a) GENERAL RULE.—Subchapter M of chapter 1 (relating to regulated investment companies and real estate investment trusts) is amended by adding at the end thereof the following new part:

"PART IV—REAL ESTATE MORTGAGE INVESTMENT CONDUITS

"Sec. 860A. Taxation of REMIC's.
"Sec. 860B. Taxation of holders of regular interests.
"Sec. 860C. Taxation of residual interests.
"Sec. 860D. REMIC defined.
"Sec. 860E. Treatment of income in excess of daily accruals on residual interests.
"Sec. 860F. Other rules.
"Sec. 860G. Other definitions and special rules.

"SEC. 860A. TAXATION OF REMIC's.

"(a) General Rule.—Except as otherwise provided in this part, a REMIC shall not be subject to taxation under this chapter (and shall not be treated as a corporation, partnership, or trust for purposes of this chapter).

"(b) Income Taxable to Holders.—The income of any REMIC shall be taxable to the holders of interests in such REMIC as provided in this part.

"SEC. 860B. TAXATION OF HOLDERS OF REGULAR INTERESTS.

"(a) General Rule.—In determining the tax under this chapter of any holder of a regular interest in a REMIC, such interest (if not otherwise a debt instrument) shall be treated as a debt instrument.

"(b) Holders Must Use Accrual Method.—The amounts includible in gross income with respect to any regular interest in a REMIC shall be determined under the accrual method of accounting.

"(c) Portion of Gain Treated as Ordinary Income.—Gain on the disposition of a regular interest shall be treated as ordinary income to the extent such gain does not exceed the excess (if any) of—

"(1) the amount which would have been includible in the gross income of the taxpayer with respect to such interest if the yield on such interest were 110 percent of the applicable Federal rate (as defined in section 1274(d) without regard to paragraph (2) thereof) as of the beginning of the taxpayer's holding period, over

"(2) the amount actually includible in gross income with respect to such interest by the taxpayer.

"(d) Cross Reference.—

"For special rules in determining inclusion of original issue discount on regular interests, see section 1272(a)(6).

"SEC. 860C. TAXATION OF RESIDUAL INTERESTS.

"(a) Pass-Thru of Income or Loss.—

"(1) In general.—In determining the tax under this chapter of any holder of a residual interest in a REMIC, such holder shall take into account his daily portion of the taxable income or net loss of such REMIC for each day during the taxable year on which such holder held such interest.

"(2) Daily portion.—The daily portion referred to in paragraph (1) shall be determined—

"(A) by allocating to each day in any calendar quarter its ratable portion of the taxable income (or net loss) for such quarter, and

"(B) by allocating the amount so allocated to any day among the holders (on such day) of residual interests in proportion to their respective holdings on such day.

"(b) Determination of Taxable Income or Net Loss.—For purposes of this section—

"(1) Taxable income.—The taxable income of a REMIC shall be determined under an accrual method of accounting and in the same manner as in the case of an individual, except that—

"(A) regular interests in such REMIC (if not otherwise debt instruments) shall be treated as indebtedness of such REMIC,

"(B) market discount on any market discount bond shall be included in gross income for the taxable years to which it is attributable as determined under the rules of section 1276(b)(2) (and sections 1276(a) and 1277 shall not apply),

"(C) there shall not be taken into account any item of income, gain, loss, or deduction allocable to a prohibited transaction, and

"(D) the deductions referred to in section 703(a)(2) (other than any deduction under section 212) shall not be allowed.

"(2) Net loss.—The net loss of any REMIC is the excess of—

"(A) the deductions allowable in computing the taxable income of such REMIC, over

"(B) its gross income.

Such amount shall be determined with the modifications set forth in paragraph (1).

"(c) Distributions.—Any distribution by a REMIC—

"(1) shall not be included in gross income to the extent it does not exceed the adjusted basis of the interest, and

"(2) to the extent it exceeds the adjusted basis of the interest, shall be treated as gain from the sale or exchange of such interest.

"(d) Basis Rules.—

"(1) Increase in basis.—The basis of any person's residual interest in a REMIC shall be increased by the amount of the taxable income of such REMIC taken into account under subsection (a) by such person with respect to such interest.

"(2) Decreases in basis.—The basis of any person's residual interest in a REMIC shall be decreased (but not below zero) by the sum of the following amounts:

"(A) any distributions to such person with respect to such interest, and

"(B) any net loss of such REMIC taken into account under subsection (a) by such person with respect to such interest.

"(e) Special Rules.—

"(1) Amounts treated as ordinary income.—Any amount included in the gross income of any holder of a residual interest in a REMIC by reason of subsection (a) shall be treated as ordinary income.

"(2) Limitation on losses.—

"(A) In general.—The amount of the net loss of any REMIC taken into account by a holder under subsection (a) with respect to any calendar quarter shall not exceed the adjusted basis of such holder's residual interest in such REMIC as of the close of such calendar quarter (determined without regard to the adjustment under subsection (d)(2)(B) for such calendar quarter).

"(B) Indefinite carryforward.—Any loss disallowed by reason of subparagraph (A) shall be treated as incurred by the REMIC in the succeeding calendar quarter with respect to such holder.

"(3) CROSS REFERENCE.—

"For special treatment of income in excess of daily accruals, see section 860E.

"SEC. 860D. REMIC DEFINED.

"(a) GENERAL RULE.—For purposes of this title, the terms 'real estate mortgage investment conduit' and 'REMIC' mean any entity—

"(1) to which an election to be treated as a REMIC applies for the taxable year and all prior taxable years,

"(2) all of the interests in which are regular interests or residual interests,

"(3) which has 1 (and only 1) class of residual interests (and all distributions, if any, with respect to such interests are pro rata),

"(4) as of the close of the 4th month ending after the startup day and each quarter ending thereafter, substantially all of the assets of which consist of qualified mortgages and permitted investments, and

"(5) which has a taxable year which is a calendar year.

"(b) ELECTION.—

"(1) IN GENERAL.—An entity (otherwise meeting the requirements of subsection (a)) may elect to be treated as a REMIC for its 1st taxable year. Such an election shall be made on its return for such 1st taxable year. Except as provided in paragraph (2), such an election shall apply to the taxable year for which made and all subsequent taxable years.

"(2) TERMINATION.—

"(A) IN GENERAL.—If any entity ceases to be a REMIC at any time during the taxable year, such entity shall not be treated as a REMIC for such taxable year or any succeeding taxable year.

"(B) INADVERTENT TERMINATIONS.—If—

"(i) an entity ceases to be a REMIC,

"(ii) the Secretary determines that such cessation was inadvertent,

"(iii) no later than a reasonable time after the discovery of the event resulting in such cessation, steps are taken so that such entity is once more a REMIC, and

"(iv) such entity, and each person holding an interest in such entity at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such entity as a REMIC or a C corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding such terminating event, such entity shall be treated as continuing to be a REMIC (or such cessation shall be disregarded for purposes of subparagraph (A)) whichever the Secretary determines to be appropriate.

"SEC. 860E. TREATMENT OF INCOME IN EXCESS OF DAILY ACCRUALS ON RESIDUAL INTERESTS.

"(a) EXCESS INCLUSIONS MAY NOT BE OFFSET BY NET OPERATING LOSSES.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the taxable income of any holder of a residual interest in a REMIC for any taxable year shall in no event be less than the excess inclusion for such taxable year.

"(2) EXCEPTION FOR CERTAIN FINANCIAL INSTITUTIONS.—Paragraph (1) shall not apply to any organization to which section 593 applies. The Secretary may by regulations provide that the preceding sentence shall not apply where necessary or appropriate to prevent avoidance of tax imposed by this chapter.

"(b) ORGANIZATIONS SUBJECT TO UNRELATED BUSINESS TAX.—If the holder of any residual interest in a REMIC is an organization subject to the tax imposed by section 511, the excess inclusion of such holder for any taxable year shall be treated as unrelated business taxable income of such holder for purposes of section 511.

"(c) EXCESS INCLUSION.—For purposes of this section—

"(1) IN GENERAL.—The term 'excess inclusion' means, with respect to any residual interest in a REMIC for any calendar quarter, the excess (if any) of—

"(A) the amount taken into account with respect to such interest by the holder under section 860C(a), over

"(B) the sum of the daily accruals with respect to such interest for days during such calendar quarter while held by such holder.

To the extent provided in regulations, if residual interests in a REMIC do not have significant value, the excess inclusions with respect to such interests shall be the amount determined under subparagraph (A) without regard to subparagraph (B).

"(2) DETERMINATION OF DAILY ACCRUALS.—

"(A) IN GENERAL.—For purposes of this subsection, the daily accrual with respect to any residual interest for any day in any calendar quarter shall be determined by allocating to each day in such quarter its ratable portion of the product of—

"(i) the adjusted issue price of such interest at the beginning of such quarter, and

"(ii) 120 percent of the long-term Federal rate (determined on the basis of compounding at the close of each calendar quarter and properly adjusted for the length of such quarter).

"(B) ADJUSTED ISSUE PRICE.—For purposes of this paragraph, the adjusted issue price of any residual interest at the beginning of any calendar quarter is the issue price of residual interest—

"(i) increased by the amount of daily accruals for prior quarters, and

"(ii) decreased by any distribution made with respect to such interest before the beginning of such quarter.

"(C) FEDERAL LONG-TERM RATE.—For purposes of this paragraph, the term 'Federal long-term rate' means the Federal long-term rate which would have applied to the residual interest under section 1274(d) (determined without regard to paragraph (2) thereof) if it were a debt instrument.

"(d) TREATMENT OF RESIDUAL INTERESTS HELD BY REAL ESTATE INVESTMENT TRUSTS.—If a residual interest in a REMIC is held by a real estate investment trust, under regulations prescribed by the Secretary—

"(1) any excess of—

"(A) the aggregate excess inclusions determined with respect to such interests, over

"(B) the real estate investment trust taxable income (within the meaning of section 857(b)(2), excluding any net capital gain),

Shall be allocated among the shareholders of such trust in proportion to the dividends received by such shareholders from trust, and

"(2) any amount allocated to a shareholder under paragraph (1) shall be treated as an excess inclusion with respect to a residual interest held by such shareholder.

"SEC. 860F. OTHER RULES.

"(a) 100 PERCENT TAX ON PROHIBITED TRANSACTIONS.—

"(1) TAX IMPOSED.—There is hereby imposed for each taxable year of a REMIC a tax equal to 100 percent of the net income derived from prohibited transactions.

"(2) PROHIBITED TRANSACTION.—For purposes of this part, the term 'prohibited transaction' means—

"(A) DISPOSITION OF QUALIFIED MORTGAGE.—The disposition of any qualified mortgage transferred to the REMIC other than a disposition pursuant to—

"(i) the substitution of a qualified replacement mortgage for a qualified mortgage,

"(ii) a disposition incident to the foreclosure, default, or imminent default of the mortgage,

"(iii) the bankruptcy or insolvency of the real estate mortgage pool, or

"(iv) a qualified liquidation.

Notwithstanding the preceding sentence, the term 'prohibited transaction' shall not include any disposition required to prevent default on a regular interest where the threatened default resulted from a default on 1 or more qualified mortgages.

"(B) INCOME FROM NONPERMITTED ASSETS.—The receipt of any income attributable to any asset which is neither a qualified mortgage nor a permitted investment.

"(C) COMPENSATION FOR SERVICES.—The receipt by the real estate mortgage pool of any amount representing a fee or other compensation for services.

"(D) GAIN FROM DISPOSITION OF CASH FLOW INVESTMENTS.—Gain from the disposition of any cash flow investment other than pursuant to any qualified liquidation described in subsection (b).

"(3) DETERMINATION OF NET INCOME.—For purposes of paragraph (1), the term 'net income derived from prohibited transactions' means the excess of the gross income from prohibited transactions over the deductions allowed by this chapter which are directly connected with such transactions; except that there

shall not be taken into account any item attributable to any prohibited transaction for which there was a loss.

"(4) Qualified liquidation.—For purposes of this part—

"(A) In general.—The term 'qualified liquidation' means a transaction in which—

"(i) the REMIC adopts a plan of complete liquidation,

"(ii) such REMIC sells all its assets (other than cash) within the liquidation period, and

"(iii) all proceeds of the liquidation (plus the cash), less assets retained to meet claims, are credited or distributed to holders of regular or residual interests on or before the last day of the liquidation period.

"(B) Liquidation period.—The term 'liquidation period' means the period—

"(i) beginning on the date of the adoption of the plan of liquidation, and

"(ii) ending at the close of the 90th day after such date.

"(b) Treatment of Transfers to the REMIC.—

"(1) Treatment of transferor.—

"(A) Nonrecognition gain or loss.—No gain or loss shall be recognized to the transferor on the transfer of any property to a REMIC.

"(B) Adjusted bases of interests.—The adjusted bases of the regular and residual interests received in a transfer described in subparagraph (A) shall be equal to the aggregate adjusted bases of the property transferred in such transfer. Such amount shall be allocated among such interests in proportion to their respective fair market values.

"(C) Treatment of nonrecognized gain.—If the issue price of any regular or residual interest exceeds its adjusted basis as determined under subparagraph (B), for periods during which such interest is held by the transferor (or by any other person whose basis is determined in whole or in part by reference to the basis of such interest in the hand of the transferor)—

"(i) in the case of a regular interest, such excess shall be included in gross income (as determined under rules similar to rules of section 1276(b)), and

"(ii) in the case of a residual interest, such excess shall be included in gross income ratably over the anticipated period during which the real estate mortgage pool will be in existence.

"(D) Treatment of nonrecognized loss.—If the adjusted basis of any regular or residual interest received in a transfer described in subparagraph (A) exceeds its issue price, for periods during which such interest is held by the transferor (or by any other person whose basis is determined in whole or in part by reference to the basis of such interest in the hand of the transferor)—

"(i) in the case of a regular interest, such excess shall be allowable as a deduction under rules similar to the rules of section 171, and

"(ii) in the case of a residual interest, such excess shall be allowable as a deduction ratably over the anticipated period during which the real estate mortgage pool will be in existence.

"(2) BASIS TO REMIC.—The basis of any property received by a REMIC in a transfer described in paragraph (1)(A) shall be its fair market value immediately after such transfer.

"(c) DISTRIBUTIONS OF PROPERTY.—If a REMIC makes a distribution of property with respect to any regular or residual interest—

"(1) notwithstanding any other provision of this subtitle, gain shall be recognized to such REMIC on the distribution in the same manner as if it had sold such property to the distributee at its fair market value, and

"(2) the basis of the distributee in such property shall be its fair market value.

"(d) COORDINATION WITH WASH SALE RULES.—For purposes of section 1091—

"(1) any residual interest in a REMIC shall be treated as a security, and

"(2) in applying such section to any loss claimed to have been sustained on the sale or other disposition of a residual interest in a REMIC—

"(A) except as provided in regulations, any residual interest in any REMIC and any interest in a taxable mortgage pool (as defined in section 7701(i)) comparable to a residual interest in a REMIC shall be treated as substantially identical stock or securities, and

"(B) subsections (a) and (e) of such section shall be applied by substituting '6 months' for '30 days' each place it appears.

"(e) TREATMENT UNDER SUBTITLE F.—For purposes of subtitle F, a REMIC shall be treated as a partnership (and holders of residual interests in such REMIC shall be treated as partners). Any return required by reason of the preceding sentence shall include the amount of the daily accruals determined under section 860E(c).

"SEC. 860G. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) DEFINITIONS.—For purposes of this part—

"(1) REGULAR INTEREST.— The term 'regular interest' means an interest in a REMIC the terms of which are fixed on the startup day, and which—

"(A) unconditionally entitles the holder to receive a specified principal amount (or other similar amount), and

"(B) provides that interest payments (or other similar amounts), if any, at or before maturity are payable based on a fixed rate (or to the extent provided in regulations, at a variable rate).

An interest shall not fail to meet the requirements of subparagraph (A) merely because the timing (but not the amount) of the principal payments (or other similar amounts) may be contingent on the extent of prepayments on qualified mortgages and the amount of income from permitted investments.

"(2) Residual interest.—The term 'residual interest' means an interest in a REMIC which is not a regular interest and is designated as a residual interest.

"(3) Qualified mortgage.—The term 'qualified mortgage' means—

"(A) any obligation (including any participation or certificate of beneficial ownership therein) which is principally secured, directly or indirectly, by an interest in real property and which—

"(i) is transferred to the REMIC on or before the startup day, or

"(ii) is purchased by the REMIC within the 3-month period beginning on the startup day,

"(B) any qualified replacement mortgage, and

"(C) any regular interest in another REMIC transferred to the REMIC on or before the startup day.

"(4) Qualified replacement mortgage.—The term 'qualified replacement mortgage' means any obligation—

"(A) which would be described in paragraph (3)(A) if it were transferred to the REMIC on or before the startup day, and

"(B) which is received for—

"(i) another obligation within the 3-month period beginning on the startup day, or

"(ii) a defective obligation within the 2-year period beginning on the startup day.

"(5) Permitted investments.—The term 'permitted investments' means any—

"(A) cash flow investment,

"(B) qualified reserve asset, or

"(C) foreclosure property.

"(6) Cash flow investment.—The term 'cash flow investment' means any investment of amounts received under qualified mortgages for a temporary period before distribution to holders of interests in the REMIC.

"(7) Qualified reserve asset.—

"(A) In general.—The term 'qualified reserve asset' means any intangible property which is held for investment and as part of a qualified reserve fund.

"(B) Qualified reserve fund.—For purposes of subparagraph (A), the term 'qualified reserve fund' means any reasonably required reserve to provide for full payment of expenses of the REMIC or amounts due on regular interests in the event of defaults on qualified mortgages. The amount of any such reserve shall be promptly and appropriately reduced as payments of qualified mortgages are received.

"(C) Special rule.—A reserve shall not be treated as a qualified reserve for any taxable year (and all subsequent taxable years) if more than 30 percent of the gross income from the assets in such fund for the taxable year is derived from the sale or other disposition of property held for less than 3 months. For purposes of the preceding sentence, gain on the disposition of a qualified reserve asset shall not be

taken into account if the disposition giving rise to such gain is required to prevent default on a regular interest where the threatened default resulted from a default on 1 or more qualified mortgages.

"(8) FORECLOSURE PROPERTY.—*The term 'foreclosure property' means property—*

"*(A) which would be foreclosure property under section 856(e) if acquired by a real estate investment trust, and*

"*(B) which is acquired in connection with the default or imminent default of a qualified mortgage held by the REMIC.*

Property shall cease to be foreclosure property with respect to the REMIC on the date which is 1 year after the date such real estate mortgage pool acquired such property.

"(9) STARTUP DAY.—*The term 'startup day' means any day selected by a REMIC which is on or before the 1st day on which interests in such REMIC are issued.*

"(10) ISSUE PRICE.—*The issue price of any regular or residual interest in a REMIC shall be determined under section 1273(b) in the same manner as if such interest were a debt instrument; except that if the interest is issued for property, paragraph (3) of section 1273(b) shall apply whether or not the requirements of such paragraph are met.*

"(b) TREATMENT OF NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—*If the holder of a residual interest in a REMIC is a nonresident alien individual or a foreign corporation, for purposes of sections 871(a), 881, 1441, and 1442—*

"*(1) amounts includible in the gross income of such holder under this part shall be taken into account when paid or distributed (or when the interest is disposed of), and*

"*(2) no exemption from the taxes imposed by such sections (and no reduction in the rates of such taxes) shall apply to any excess inclusion.*

The Secretary may by regulations provide that such amounts shall be taken into account earlier than as provided in paragraph (1) where necessary or appropriate to prevent the avoidance of tax imposed by this chapter.

"(c) REGULATIONS.—*The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part, including regulations—*

"*(1) to prevent unreasonable accumulations of assets in a REMIC,*

"*(2) permitting determinations of the fair market value of property transferred to a REMIC and issue price of interests in a REMIC to be made earlier than otherwise provided, and*

"*(3) requiring reporting to holders of residual interests of such information as frequently as is necessary or appropriate to permit such holders to compute their taxable income accurately.*"

(b) TECHNICAL AMENDMENTS.—

(1) TREATMENT FOR REIT PURPOSES.—*Paragraph (6) of section 856(c) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:*

"(D) A regular or residual interest in a REMIC shall be treated as an interest in real property, and any amount includible in gross income with respect to such an interest shall be treated as interest; except that, if less than 95 percent of the assets of such REMIC are interests in real property (determined as if the taxpayer held such assets), such interest shall be so treated only in the proportion which the assets of the REMIC consist of such interests."

(2) Treatment for purposes of section 593.—Subsection (d) of section 593 (defining loans) is amended by adding at the end thereof the following new paragraph:

"(4) Treatment of interests in REMIC's.—A regular or residual interest in a REMIC shall be treated as a qualifying real property loan; except that, if less than 95 percent of the assets of such REMIC are qualifying real property loans (determined as if the taxpayer held the assets of the REMIC), such interest shall be so treated only in the proportion which the assets of such REMIC consist of such loans."

(3) Treatment for purposes of section 7701(a)(19).—Subparagraph (C) of section 7701(a)(19) (defining domestic building and loan associations) is amended by striking out "and" at the end of clause (ix), by striking out the period at the end of clause (x) and inserting in lieu thereof ", and", and by inserting after clause (x) the following new clause:

"(xi) any regular or residual interest in a REMIC, but only in the proportion which the assets of such REMIC consist of property described in any of the preceding clauses of this subparagraph; except that if 95 percent or more of the assets of such REMIC are loans described in clauses (i) through (x), the entire interest in the REMIC shall qualify."

(4) Treatment for purposes of section 582(c).—Paragraph (1) of section 582(c) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, any regular or residual interest in a REMIC shall be treated as an evidence of indebtedness."

SEC. 672. RULES FOR ACCRUING ORIGINAL ISSUE DISCOUNT ON REGULAR INTERESTS AND SIMILAR DEBT INSTRUMENTS.

Subsection (a) of section 1272 (relating to current inclusion in income of original issue discount) is amended by redesignating paragraph (6) as paragraph (7) and by inserting after paragraph (5) the following new paragraph:

"(6) Determination of daily portions where principal subject to acceleration.—

"(A) In general.—In the case of any debt instrument to which this paragraph applies, the daily portion of the original issue discount shall be determined by allocating to each day in any accrual period its ratable portion of the excess (if any) of—

"(i) the sum of (I) the present value determined under subparagraph (B) of all remaining payments under the debt instrument as of the close of such period, and (II) the payments during the accrual period of amounts in-

cluded in the stated redemption price of the debt instrument, over

"(ii) the adjusted issue price of such debt instrument at the beginning of such period.

"(B) DETERMINATION OF PRESENT VALUE.—For purposes of subparagraph (A), the present value shall be determined on the basis of—

"(i) the original yield to maturity (determined on the basis of compounding at the close of each accrual period and properly adjusted for the length of the accrual period),

"(ii) events which have occurred before the close of the accrual period, and

"(iii) a prepayment assumption determined in the manner prescribed by regulations.

"(C) DEBT INSTRUMENTS TO WHICH PARAGRAPH APPLIES.—This paragraph applies to—

"(i) any regular interest in a REMIC or qualified mortgage held by a REMIC, or

"(ii) any other debt instrument if payments under such debt instrument may be accelerated by reason of prepayments of other obligations securing such debt instrument (or, to the extent provided in regulations, by reason of other events)."

SEC. 673. TREATMENT OF TAXABLE MORTGAGE POOLS.

Section 7701, as amended by section 201(c), is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) TAXABLE MORTGAGE POOLS.—

"(1) TREATED AS SEPARATE CORPORATIONS.—A taxable mortgage pool shall be treated as a separate corporation which may not be treated as an includible corporation with any other corporation for purposes of section 1501.

"(2) TAXABLE MORTGAGE POOL DEFINED.—For purposes of this title—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, a taxable mortgage pool is any entity (other than a REMIC) if—

"(i) substantially all of the assets of such entity consists of debt obligations (or interests therein) and more than 50 percent of such debt obligations (or interests) consists of real estate mortgages (or interests therein),

"(ii) such entity is the obligor under debt obligations with 2 or more maturities, and

"(iii) under the terms of the debt obligations referred to in clause (ii) (or underlying arrangement), payments on such debt obligations bear a relationship to payments on the debt obligations (or interests) referred to in clause (i).

"(B) PORTION OF ENTITIES TREATED AS POOLS.—Any portion of an entity which meets the definition of subparagraph (A) shall be treated as a taxable mortgage pool.

"(C) EXCEPTION FOR DOMESTIC BUILDING AND LOAN.—Nothing in this subsection shall be construed to treat any domestic building and loan association (or portion thereof) as a taxable mortgage pool.

"(D) TREATMENT OF CERTAIN EQUITY INTERESTS.—To the extent provided in regulations, equity interest of varying classes which correspond to maturity classes of debt shall be treated as debt for purposes of this subsection.

"(3) TREATMENT OF CERTAIN REIT's.—If—

"(A) a real estate investment trust is a taxable mortgage pool, or

"(B) a qualified REIT subsidiary (as defined in section 856(i)(2)) of a real estate investment trust is a taxable mortgage pool,

under regulations prescribed by the Secretary, adjustments similar to the adjustments provided in section 860E(d) shall apply to the shareholders of such real estate investment trust."

SEC. 674. COMPLIANCE PROVISIONS.

Subsection (d) of section 6049 (relating to returns regarding payments of interest) is amended by adding at the end thereof the following new paragraph:

"(7) INTERESTS IN REMIC'S AND CERTAIN OTHER DEBT INSTRUMENTS.—

"(A) IN GENERAL.—For purposes of subsection (a), the term 'interest' includes amounts includible in gross income with respect to regular interests in REMIC's.

"(B) REPORTING TO CORPORATIONS, ETC.—Except as otherwise provided in regulations, in the case of any interest described in subparagraph (A) of this paragraph and any other debt instrument to which section 1272(a)(6) applies, subsection (b)(4) of this section shall be applied without regard to subparagraphs (A), (H), (I), (J), (K), and (L)(i).

"(C) ADDITIONAL INFORMATION.—Except as otherwise provided in regulations, any return or statement required to be filed or furnished under this section with respect to interest income described in subparagraph (A) and interest on any other debt instrument to which section 1272(a)(6) applies shall also provide information setting forth the issue price of the interest to which the return or statement relates at the beginning of each accrual period with respect to which interest income is required to be reported on such return or statement and information necessary to compute accrual of market discount.

"(D) REGULATORY AUTHORITY.—The Secretary may prescribe such regulations as are necessary or appropriate to carry out the purposes of this paragraph, including regulations which require more frequent or more detailed reporting."

SEC. 675. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as otherwise provided in this section, the amendments made by this part shall apply to taxable years beginning after December 31, 1986.

(b) Rules for Accruing Original Issue Discount.—The amend-ent made by section 672 shall apply to debt instruments issued fter December 31, 1986, in taxable years ending after such date.

(c) Treatment of Taxable Mortgage Pools.—

(1) In general.—The amendment made by section 673 shall take effect on January 1, 1992.

(2) Treatment of existing entities.—The amendment made by section 673 shall not apply to any entity in existence on December 31, 1991. The preceding sentence shall cease to apply with respect to any entity as of the 1st day after December 31, 1991, on which there is a substantial transfer of cash or other property to such entity.

(3) Special rule for coordination with wash-sale rules.—Notwithstanding paragraphs (1) and (2), for purposes of applying section 860F(d) of the Internal Revenue Code of 1986 (as added by this part), the amendment made by section 673 shall apply to taxable years beginning after December 31, 1986.

TITLE VII—ALTERNATIVE MINIMUM TAX

EC. 701. ALTERNATIVE MINIMUM TAX FOR INDIVIDUALS AND CORPORATIONS.

(a) General Rule.—Part VI of subchapter A of chapter 1 (relat-ng to minimum tax for tax preferences) is amended to read as fol-lows:

"PART VI—ALTERNATIVE MINIMUM TAX

"Sec. 55. Alternative minimum tax imposed.
"Sec. 56. Adjustments in computing alternative minimum taxable income.
"Sec. 57. Items of tax preference.
"Sec. 58. Denial of certain losses.
"Sec. 59. Other definitions and special rules.

"SEC. 55. ALTERNATIVE MINIMUM TAX IMPOSED.

"(a) General Rule.—There is hereby imposed (in addition to any other tax imposed by this subtitle) a tax equal to the excess (if any) of—

"(1) the tentative minimum tax for the taxable year, over

"(2) the regular tax for the taxable year.

"(b) Tentative Minimum Tax.—For purposes of this part—

"(1) In general.—The tentative minimum tax for the taxable year is—

"(A) 20 percent (21 percent in the case of a taxpayer other than a corporation) of so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount, reduced by

"(B) the alternative minimum tax foreign tax credit for the taxable year.

"(2) Alternative minimum taxable income.—The term 'alternative minimum taxable income' means the taxable income of the taxpayer for the taxable year—

"(A) determined with the adjustments provided in section 56 and section 58, and

"(B) increased by the amount of the items of tax preference described in section 57.

"(c) Regular Tax.—

"(1) In general.—For purposes of this section, the term 'regular tax' means the regular tax liability for the taxable year (as defined in section 26(b)) reduced by the foreign tax credit allowable under section 27(a). Such term shall not include any tax imposed by section 402(e) and shall not include any increase in tax under section 47.

"(2) Cross references.—

> ***"For provisions providing that certain credits are not allowable against the tax imposed by this section, see sections 26(a), 28(d)(2), 29(b)(5), and 38(c).***

"(d) Exemption Amount.—For purposes of this section—

"(1) Exemption amount for taxpayers other than corporations.—In the case of a taxpayer other than a corporation, the term 'exemption amount' means—

"(A) $40,000 in the case of—

"(i) a joint return, or

"(ii) a surviving spouse,

"(B) $30,000 in the case of an individual who—

"(i) is not a married individual, and

"(ii) is not a surviving spouse, and

"(C) $20,000 in the case of—

"(i) a married individual who files a separate return, or

"(ii) an estate or trust.

For purposes of this paragraph, the term 'surviving spouse' has the meaning given to such term by section 2(a), and marital status shall be determined under section 7703.

"(2) Corporations.—In the case of a corporation, the term 'exemption amount' means $40,000.

"(3) Phase-out of exemption amount.—The exemption amount of any taxpayer shall be reduced (but not below zero) by an amount equal to 25 percent of the amount by which the alternative minimum taxable income of the taxpayer exceeds—

"(A) $150,000 in the case of a taxpayer described in paragraph (1)(A) or (2),

"(B) $112,500 in the case of a taxpayer described in paragraph (1)(B), and

"(C) $75,000 in the case of a taxpayer described in paragraph (1)(C).

"SEC. 56. ADJUSTMENTS IN COMPUTING ALTERNATIVE MINIMUM TAXABLE INCOME.

"(a) Adjustments Applicable to All Taxpayers.—In determining the amount of the alternative minimum taxable income for any taxable year the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

"(1) Depreciation.—

"(A) In general.—

"(i) Property other than certain real property.—Except as provided in clause (ii), the depreciation deduction allowable under section 167 with respect to

any tangible property placed in service after December 31, 1986, shall be determined under the alternative system of section 168(g).

"(ii) 150-PERCENT DECLINING BALANCE METHOD FOR CERTAIN PROPERTY.—The method of depreciation used shall be—

"(I) the 150 percent declining balance method,

"(II) switching to the straight line method for the 1st taxable year for which using the straight line method with respect to the adjusted basis as of the beginning of the year will yield a higher allowance.

The preceding sentence shall not apply to any section 1250 property (as defined in section 1250(c)) or to any other property if the depreciation deduction determined under section 168 with respect to such other property for purposes of the regular tax is determined by using the straight line method.

"(B) EXCEPTION FOR CERTAIN PROPERTY.—This paragraph shall not apply to property described in paragraph (1), (2), (3), or (4) of section 168(f).

"(C) COORDINATION WITH TRANSITIONAL RULES.—

"(i) IN GENERAL.—This paragraph shall not apply to property placed in service after December 31, 1986, to which the amendments made by section 201 of the Tax Reform Act of 1986 do not apply.

"(ii) TREATMENT OF CERTAIN PROPERTY PLACED IN SERVICE BEFORE 1987.—This paragraph shall apply to any property to which the amendments made by section 201 of the Tax Reform Act of 1986 apply by reason of an election under section 203(a)(1)(B) of such Act without regard to the requirement of subparagraph (A) that the property be placed in service after December 31, 1986.

"(D) NORMALIZATION RULES.—With respect to public utility property described in section 167(l)(3)(A), the Secretary shall prescribe the requirements of a normalization method of accounting for this section.

"(2) MINING EXPLORATION AND DEVELOPMENT COSTS.—

"(A) IN GENERAL.—With respect to each mine or other natural deposit (other than an oil, gas, or geothermal well) of the taxpayer, the amount allowable as a deduction under section 616(a) or 617(a) (determined without regard to section 291(b)) in computing the regular tax for costs paid or incurred after December 31, 1986, shall be capitalized and amortized ratably over the 10-year period beginning with the taxable year in which the expenditures were made.

"(B) LOSS ALLOWED.—If a loss is sustained with respect to any property described in subparagraph (A), a deduction shall be allowed for the expenditures described in subparagraph (A) for the taxable year in which such loss is sustained in an amount equal to the lesser of—

"(i) the amount allowable under section 165(a) for the expenditures if they had remained capitalized, or

"(ii) the amount of such expenditures which have not previously been amortized under subparagraph (A).

"(3) Treatment of certain long-term contracts.—In the case of any long-term contract entered into by the taxpayer on or after March 1, 1986, the taxable income from such contract shall be determined under the percentage of completion method of accounting (as modified by section 460(b)).

"(4) Alternative tax net operating loss deduction.—The alternative tax net operating loss deduction shall be allowed in lieu of the net operating loss deduction allowed under section 172.

"(5) Pollution control facilities.—In the case of any certified pollution control facility placed in service after December 31, 1986, the deduction allowable under section 169 (without regard to section 291) shall be determined under the alternative system of section 168(g).

"(6) Installment sales of certain property.—In the case of any—

"(A) disposition after March 1, 1986, of property described in section 1221(1), or

"(B) other disposition if an obligation arising from such disposition would be an applicable installment obligation (as defined in section 453C(e)) to which section 453C applies,

income from such disposition shall be determined without regard to the installment method under section 453 or 453A and all payments to be received for the disposition shall be deemed received in the taxable year of the disposition. This paragraph shall not apply to any disposition with respect to which an election is in effect under section 453C(e)(4).

"(7) Adjusted basis.—The adjusted basis of any property to which paragraph (1) or (5) applies (or with respect to which there are any expenditures to which paragraph (2) or subsection (b)(2) applies) shall be determined on the basis of the treatment prescribed in paragraph (1), (2), or (5), or subsection (b)(2), whichever applies.

"(b) Adjustments Applicable to Individuals.—In determining the amount of the alternative minimum taxable income of any taxpayer (other than a corporation), the following treatment shall apply (in lieu of the treatment applicable for purposes of computing the regular tax):

"(1) Limitation on itemized deductions.—

"(A) In general.—No deduction shall be allowed—

"(i) for any miscellaneous itemized deduction (as defined in section 67(b)), or

"(ii) for any taxes described in paragraph (1), (2), or (3) of section 164(a).

Clause (ii) shall not apply to any amount allowable in computing adjusted gross income.

"(B) Medical expenses.—In determining the amount allowable as a deduction under section 213, subsection (a) of section 213 shall be applied by substituting '10 percent' for '7.5 percent'.

"(C) INTEREST.—In determining the amount allowable as a deduction for interest, subsections (d) and (h) of section 163 shall apply, except that—

"(i) in lieu of the exception under section 163(h)(2)(D), the term 'personal interest' shall not include any qualified housing interest (as defined in subsection (e)),

"(ii) sections 163(d)(6) and 163(h)(6) (relating to phase-ins) shall not apply, and

"(iii) interest on any specified private activity bond (and any amount treated as interest on a specified activity bond under section 56(a)(5)(B)), and any deduction referred to in section 57(a)(5)(A), shall be treated as includible in gross income (or as deductible) for purposes of applying section 163(d).

"(D) TREATMENT OF CERTAIN RECOVERIES.—No recovery of any tax to which subparagraph (A)(ii) applied shall be included in gross income for purposes of determining alternative minimum taxable income.

"(E) STANDARD DEDUCTION NOT ALLOWED.—The standard deduction provided in section 63(c) shall not be allowed.

"(2) CIRCULATION AND RESEARCH AND EXPERIMENTAL EXPENDITURES.—

"(A) IN GENERAL.—The amount allowable as a deduction under section 173 or 174(a) in computing the regular tax for amounts paid or incurred after December 31, 1986, shall be capitalized and—

"(i) in the case of circulation expenditures described in section 173, shall be amortized ratably over the 3-year period beginning with the taxable year in which the expenditures were made, or

"(ii) in the case of research and experimental expenditures described in section 174(a), shall be amortized ratably over the 10-year period beginning with the taxable year in which the expenditures were made.

"(B) LOSS ALLOWED.—If a loss is sustained with respect to any property described in subparagraph (A), a deduction shall be allowed for the expenditures described in subparagraph (A) for the taxable year in which such loss is sustained in an amount equal to the lesser of—

"(i) the amount allowable under section 165(a) for the expenditures if they had remained capitalized, or

"(ii) the amount of such expenditures which have not previously been amortized under subparagraph (A).

"(C) SPECIAL RULE FOR PERSONAL HOLDING COMPANIES.—In the case of circulation expenditures described in section 173, the adjustments provided in this paragraph shall apply also to a personal holding company (as defined in section 542).

"(c) ADJUSTMENTS APPLICABLE TO CORPORATIONS.—In determining the amount of the alternative minimum taxable income of a corporation, the following treatment shall apply:

"(1) ADJUSTMENT FOR BOOK INCOME OR ADJUSTED EARNINGS AND PROFITS.—

"(A) BOOK INCOME ADJUSTMENT.—For taxable years beginning in 1987, 1988, and 1989, alternative minimum taxable income shall be adjusted as provided under subsection (f).

"(B) ADJUSTED EARNINGS AND PROFITS.—For taxable years beginning after 1989, alternative minimum taxable income shall be adjusted as provided under subsection (g).

"(2) MERCHANT MARINE CAPITAL CONSTRUCTION FUNDS.—In the case of a capital construction fund established under section 607 of the Merchant Marine Act, 1936 (46 U.S.C. 1177)—

"(A) subparagraphs (A), (B), and (C) of section 7518(c)(1) (and the corresponding provisions of such section 607) shall not apply to—

"(i) any amount deposited in such fund after December 31, 1986, or

"(ii) any earnings (including gains and losses) after December 31, 1986, on amounts in such fund, and

"(B) no reduction in basis shall be made under section 7518(f) (or the corresponding provisions of such section 607) with respect to the withdrawal from the fund of any amount to which subparagraph (A) applies.

For purposes of this paragraph, any withdrawal of deposits or earnings from the fund shall be treated as allocable first to deposits made before (and earnings received or accrued before) January 1, 1987.

"(3) SPECIAL DEDUCTION FOR CERTAIN ORGANIZATIONS NOT ALLOWED.—The deduction determined under section 833(b) shall not be allowed.

"(d) ALTERNATIVE TAX NET OPERATING LOSS DEDUCTION DEFINED.—

"(1) IN GENERAL.—For purposes of subsection (a)(4), the term 'alternative tax net operating loss deduction' means the net operating loss deduction allowable for the taxable year under section 172, except that—

"(A) the amount of such deduction shall not exceed 90 percent of alternative minimum taxable income determined without regard to such deduction, and

"(B) in determining the amount of such deduction—

"(i) the net operating loss (within the meaning of section 172(c)) for any loss year shall be adjusted as provided in paragraph (2), and

"(ii) in the case of taxable years beginning after December 31, 1986, section 172(b)(2) shall be applied by substituting '90 percent of alternative minimum taxable income determined without regard to the alternative tax net operating loss deduction' for 'taxable income' each place it appears.

"(2) ADJUSTMENTS TO NET OPERATING LOSS COMPUTATION.—

"(A) POST-1986 LOSS YEARS.—In the case of a loss year beginning after December 31, 1986, the net operating loss for such year under section 172(c) shall—

"(i) be determined with the adjustments provided in this section and section 58, and

"(ii) be reduced by the items of tax preference determined under section 57 for such year (other than subsection (a)(6) thereof).

"(B) Pre-1987 years.—In the case of loss years beginning before January 1, 1987, the amount of the net operating loss which may be carried over to taxable years beginning after December 31, 1986, for purposes of paragraph (2), shall be equal to the amount which may be carried from the loss year to the first taxable year of the taxpayer beginning after December 31, 1986.

"(e) Qualified Housing Interest.—For purposes of this part—

"(1) In general.—The term 'qualified housing interest' means interest which is paid or accrued during the taxable year on indebtedness which is incurred in acquiring, constructing, or substantially rehabilitating any property which—

"(A) is the principal residence (within the meaning of section 1034) of the taxpayer at the time such interest accrues or is paid, or

"(B) is a qualified dwelling which is a qualified residence (within the meaning of section 163(h)(3)).

Such term also includes interest on any indebtedness resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence; but only to the extent that the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness immediately before the refinancing.

"(2) Qualified dwelling.—The term 'qualified dwelling' means any—

"(A) house,

"(B) apartment,

"(C) condominium, or

"(D) mobile home not used on a transient basis (within the meaning of section 7701(a)(19)(C)(v)),

including all structures or other property appurtenant thereto.

"(3) Special rule for indebtedness incurred before July 1, 1982.—The term 'qualified housing interest' includes interest paid or accrued on indebtedness which—

"(A) was incurred by the taxpayer before July 1, 1982, and

"(B) is secured by property which, at the time such indebtedness was incurred, was—

"(i) the principal residence (within the meaning of section 1034) of the taxpayer, or

"(ii) a qualified dwelling used by the taxpayer (or any member of his family (within the meaning of section 267(c)(4))).

"(f) Adjustments for Book Income of Corporations.—

"(1) In general.—The alternative minimum taxable income of any corporation for any taxable year beginning in 1987, 1988, or 1989 shall be increased by 50 percent of the amount (if any) by which—

"(A) the adjusted net book income of the corporation, exceeds

"(B) the alternative minimum taxable income for the taxable year (determined without regard to this subsection and the alternative tax net operating loss deduction).

"(2) Adjusted net book income.—For purposes of this subsection—

"(A) In general.—The term 'adjusted net book income' means the net income or loss of the taxpayer set forth on the taxpayer's applicable financial statement, adjusted as provided in this paragraph.

"(B) Adjustments for certain taxes.—The amount determined under subparagraph (A) shall be appropriately adjusted to disregard any Federal income taxes, or income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States, which are directly or indirectly taken into account on the taxpayer's applicable financial statement. The preceding sentence shall not apply to any such taxes imposed by a foreign country or possession of the United States if the taxpayer does not choose to take, to any extent, the benefits of section 901.

"(C) Special rules for related corporations.—

"(i) Consolidated returns.—If the taxpayer files a consolidated return for any taxable year, adjusted net book income for such taxable year shall take into account items on the taxpayer's applicable financial statement which are properly allocable to members of such group included on such return.

"(ii) Treatment of dividends.—In the case of any corporation which is not included on a consolidated return with the taxpayer, adjusted net book income shall take into account the earnings of such other corporation only to the extent of the sum of the dividends received from such other corporation and other amounts required to be included in gross income under this chapter in respect of the earnings of such other corporation.

"(D) Statements covering different periods.—Appropriate adjustments shall be made in adjusted net book income in any case in which an applicable financial statement covers a period other than the taxable year.

"(E) Special rule for cooperatives.—In the case of a cooperative to which section 1381 applies, the amount determined under subparagraph (A) shall be reduced by the amounts referred to in section 1382(b) (relating to patronage dividends and per-unit retain allocations) to the extent such amounts were not otherwise taken into account in determining adjusted net book income.

"(F) Treatment of dividends from 936 corporations.—

"(i) In general.—In determining the amount of adjusted net book income, any dividend received from a corporation eligible for the credit provided by section 936 shall be increased by the amount of any withholding tax paid to a possession of the United States with respect to such dividend.

"(ii) TREATMENT AS FOREIGN TAXES.—

"(I) IN GENERAL.—50 percent of any withholding tax paid to a possession of the United States with respect to dividends referred to in clause (i) (to the extent such dividends do not exceed the excess referred to in paragraph (1), determined without regard to clause (i)) shall, for purposes of this part, be treated as a tax paid by the corporation receiving the dividend to a foreign country.

"(II) TREATMENT OF TAXES IMPOSED ON 936 CORPORATION.—For purposes of this subparagraph, taxes paid by any corporation eligible for the credit provided by section 936 to a possession of the United States, shall be treated as a withholding tax paid with respect to any dividend paid by such corporation to the extent such taxes would be treated as paid by the corporation receiving the dividend under rules similar to the rules of section 902.

"(G) RULES FOR ALASKA NATIVE CORPORATIONS.—The amount determined under subparagraph (A) shall be appropriately adjusted to allow:

"(i) cost recovery and depletion attributable to property the basis of which is determined under section 21(c) of the Alaska Native Claims Settlement Act (43 U.S.C. 1620(c)), and

"(ii) deductions for amounts payable made pursuant to section 7(i) or section 7(j) of such Act (43 U.S.C. 1606(i) and 1606(j)) only at such time as the deductions are allowed for tax purposes.

"(H) SECRETARIAL AUTHORITY TO ADJUST ITEMS.—Under regulations, adjusted net book income shall be properly adjusted to prevent the omission or duplication of any item.

"(3) APPLICABLE FINANCIAL STATEMENT.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'applicable financial statement' means, with respect to any taxable year, any statement covering such taxable year—

"(i) which is required to be filed with the Securities and Exchange Commission,

"(ii) which is a certified audited income statement to be used for the purposes of a statement or report—

"(I) for credit purposes,

"(II) to shareholders, or

"(III) for any other substantial nontax purpose,

"(iii) which is an income statement required to be provided to—

"(I) the Federal Government or any agency thereof,

"(II) a State government or any agency thereof, or

"(III) a political subdivision of a State or any agency thereof, or

"(iv) which is an income statement to be used for the purposes of a statement or report—

"(I) for credit purposes,

"(II) to shareholders, or

"(III) for any other substantial nontax purpose.

"(B) EARNINGS AND PROFITS USED IN CERTAIN CASES.—If—

"(i) a taxpayer has no applicable financial statement, or

"(ii) a taxpayer has only a statement described in subparagraph (A)(iv) and the taxpayer elects the application of this subparagraph,

the net income or loss set forth on the taxpayer's applicable financial statement shall, for purposes of paragraph (3)(A), be treated as being equal to the taxpayer's earnings and profits for the taxable year (without diminution by reason of distributions during the tax year). Such election, once made, shall remain in effect for any taxable year for which the taxpayer is described in this subparagraph unless revoked with the consent of the Secretary.

"(C) SPECIAL RULE WHERE MORE THAN 1 STATEMENT.—For purposes of subparagraph (A), if a taxpayer has a statement described in more than 1 clause or subclause, the applicable financial statement shall be the statement described in the clause or subclause with the lowest number designation.

"(4) EXCEPTION FOR CERTAIN CORPORATIONS.—This subsection shall not apply to any S corporation, regulated investment company, real estate investment trust, or REMIC.

"(g) ADJUSTMENTS BASED ON ADJUSTED CURRENT EARNINGS.—

"(1) IN GENERAL.—The alternative minimum taxable income of any corporation for any taxable year beginning after 1989 shall be increased by 75 percent of the excess (if any) of—

"(A) the adjusted current earnings of the corporation, over

"(B) the alternative minimum taxable income (determined without regard to this subsection and the alternative tax net operating loss deduction).

"(2) ALLOWANCE OF NEGATIVE ADJUSTMENTS.—

"(A) IN GENERAL.—The alternative minimum taxable income for any corporation of any taxable year beginning after 1989, shall be reduced by 75 percent of the excess (if any) of—

"(i) the amount referred to in subparagraph (B) of paragraph (1), over

"(ii) the amount referred to in subparagraph (A) of paragraph (1).

"(B) LIMITATION.—The reduction under subparagraph (A) for any taxable year shall not exceed the excess (if any) of—

"(i) the aggregate increases in alternative minimum taxable income under paragraph (1) for prior taxable years, over

"(ii) the aggregate reductions under subparagraph (A) of this paragraph for prior taxable years.

"(3) ADJUSTED CURRENT EARNINGS.—For purposes of this subsection, the term 'adjusted current earnings' means the alternative minimum taxable income for the taxable year—

"(A) determined with the adjustments provided in paragraph (4), and

"(B) determined without regard to this subsection and the alternative tax net operating loss deduction.

"(4) ADJUSTMENTS.—In determining adjusted current earnings, the following adjustments shall apply:

"(A) DEPRECIATION.—

"(i) PROPERTY PLACED IN SERVICE AFTER 1989.—The depreciation deduction with respect to any property placed in service in a taxable year beginning after 1989 shall be determined under whichever of the following methods yields deductions with a smaller present value:

"(I) The alternative system of section 168(g), or

"(II) The method used for book purposes.

"(ii) PROPERTY TO WHICH NEW ACRS SYSTEM APPLIES.—In the case of any property to which the amendments made by section 201 of the Tax Reform Act of 1986 apply and which is placed in service in a taxable year beginning before 1990, the depreciation deduction shall be determined—

"(I) by taking into account the adjusted basis of such property (as determined for purposes of computing alternative minimum taxable income) as of the close of the last taxable year beginning before January 1, 1990, and

"(II) by using the straight-line method over the remainder of the recovery period applicable to such property under the alternative system of section 168(g).

"(iii) PROPERTY TO WHICH ORIGINAL ACRS SYSTEM APPLIES.—In the case of any property to which section 168 (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986 and without regard to subsection (d)(1)(A)(ii) thereof) applies, the depreciation deduction shall be determined—

"(I) by taking into account the adjusted basis of such property (as determined for purposes of computing the regular tax) as of the close of the last taxable year beginning before January 1, 1990, and

"(II) by using the straight line method over the remainder of the recovery period which would apply to such property under the alternative system of section 168(g).

"(iv) PROPERTY PLACED IN SERVICE BEFORE 1981.—In the case of any property not described in clause (i), (ii), or (iii), the amount allowable as depreciation or amortization with respect to such property shall be determined in the same manner as for purposes of computing taxable income.

"(v) SLOWER METHOD USED IF USED FOR BOOK PURPOSES.—In the case of any property to which clause (ii), (iii), or (iv) applies, if the depreciation method used for book purposes yields deductions for taxable years beginning after 1989 with a smaller present value than the method which would otherwise be used under such clause, the method used for book purposes shall be used in lieu of the method which would otherwise be used under such clause.

"(B) INCLUSION OF ITEMS INCLUDED FOR PURPOSES OF COMPUTING EARNINGS AND PROFITS.—

"(i) IN GENERAL.—In the case of any amount which is excluded from gross income for purposes of computing alternative minimum taxable income but is taken into account in determining the amount of earnings and profits—

"(I) such amount shall be included in income in the same manner as if such amount were includible in gross income for purposes of computing alternative minimum taxable income, and

"(II) the amount of such income shall be reduced by any deduction which would have been allowable in computing alternative minimum taxable income if such amount were includible in gross income.

"(ii) INCLUSION OF BUILDUP IN LIFE INSURANCE CONTRACTS.—In the case of any life insurance contract—

"(I) the income on such contract (as determined under section 7702(g)) for any taxable year shall be treated as includible in gross income for such year, and

"(II) there shall be allowed as a deduction that portion of any premium which is attributable to insurance coverage.

"(iii) INCLUSION OF INCOME ON ANNUITY CONTRACT.—In the case of any annuity contract, the income on such contract (as determined under section 72(u)(2)) shall be treated as includible in gross income for such year

"(C) DISALLOWANCE OF ITEMS NOT DEDUCTIBLE IN COMPUTING EARNINGS AND PROFITS.—

"(i) IN GENERAL.—A deduction shall not be allowed for any item if such item would not be deductible for any taxable year for purposes of computing earnings and profits.

"(ii) SPECIAL RULE FOR 100-PERCENT DIVIDENDS.—Clause (i) shall not apply to any deduction allowable under section 243 or 245 for a 100-percent dividend—

"(I) if the corporation receiving such dividend and the corporation paying such dividend could not be members of the same affiliated group under section 1504 by reason of section 1504(b),

"(II) but only to the extent such dividend is attributable to income of the paying corporation which is subject to tax under this chapter (deter-

mined after the application of sections 936 and 921).

For purposes of the preceding sentence, the term '100 percent dividend' means any dividend if the percentage used for purposes of determining the amount allowable as a deduction under section 243 or 245 with respect to such dividend is 100 percent.

"(iii) SPECIAL RULE FOR DIVIDENDS FROM SECTION 936 COMPANIES.—In the case of any dividend received from a corporation eligible for the credit provided by section 936, rules similar to the rules of subparagraph (F) of subsection (f)(1) shall apply, except that '75 percent' shall be substituted for '50 percent' in clause (ii)(I) thereof.

"(D) CERTAIN OTHER EARNINGS AND PROFITS ADJUSTMENTS.—

"(i) IN GENERAL.—The adjustments provided in section 312(n) shall apply; except that—

"(I) paragraphs (1), (2), and (3) shall apply only to amounts paid or incurred in taxable years beginning after December 31, 1989,

"(II) paragraph (4) shall apply only to taxable years beginning after December 31, 1989,

"(III) paragraph (5) shall apply only to installment sales in taxable years beginning after December 31, 1989,

"(IV) paragraph (6) shall apply only to contracts entered into on or after March 1, 1986, and

"(V) paragraphs (7) and (8) shall not apply.

"(ii) SPECIAL RULE FOR INTANGIBLE DRILLING COSTS AND MINERAL EXPLORATION AND DEVELOPMENT COSTS.—If—

"(I) the present value of the deductions provided under subparagraph (A)(ii) or (B)(ii) of section 312(n)(2) with respect to amounts paid or incurred in taxable years beginning after December 31, 1989, exceeds

"(II) the present value of the deductions for such amounts under the method used for book purposes,

such amounts shall be deductible under the method used for book purposes in lieu of that provided in such subparagraph.

"(E) DISALLOWANCE OF LOSS ON EXCHANGE OF DEBT POOLS.—No loss shall be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

"(F) ACQUISITION EXPENSES OF LIFE INSURANCE COMPANIES.—Acquisition expenses of life insurance companies shall be capitalized and amortized in accordance with the treatment generally required under generally accepted accounting principles as if this subparagraph applied to all taxable years.

"(G) Depletion.—The allowances for depletion with respect to any property placed in service in a taxable year beginning after 1989, shall be determined under whichever of the following methods yields deductions with a smaller present value:

"(i) cost depletion determined under section 611, or

"(ii) the method used for book purposes.

"(H) Treatment of certain ownership changes.—If—

"(i) there is an ownership change (within the meaning of section 382) after the date of the enactment of the Tax Reform Act of 1986 with respect to any corporation, and

"(ii)(I) the aggregate adjusted bases of the assets of such corporation (immediately after the change), exceed

"(II) the value of the stock of such corporation (as determined for purposes of section 382), properly adjusted for liabilities and other relevant items,

then the adjusted basis of each asset of such corporation (as of such time) shall be its proportionate share (determined on the basis of respective fair market values) of the amount referred to in clause (ii)(II).

"(5) Other definitions.—For purposes of paragraph (4)—

"(A) Book purposes.—The term 'book purposes' means the treatment for purposes of preparing the applicable financial statement referred to in subsection (f).

"(B) Earnings and profits.—The term 'earnings and profits' means earnings and profits computed for purposes of subchapter C.

"(C) Present value.—Present value shall be determined as of the time the property is placed in service (or, if later, as of the beginning of the first taxable year beginning after 1989) and under regulations prescribed by the Secretary.

"(D) Treatment of alternative minimum taxable income.—The treatment of any item for purposes of computing alternative minimum taxable income shall be determined without regard to this subsection.

"(6) Exception for certain corporations.—This subsection shall not apply to any S corporation, regulated investment company, real estate investment trust, or REMIC.

"SEC. 57. ITEMS OF TAX PREFERENCE.

"(a) General Rule.—For purposes of this part, the items of tax preference determined under this section are—

"(1) Depletion.—With respect to each property (as defined in section 614), the excess of the deduction for depletion allowable under section 611 for the taxable year over the adjusted basis of the property at the end of the taxable year (determined without regard to the depletion deduction for the taxable year).

"(2) Intangible drilling costs.—

"(A) In general.—With respect to all oil, gas, and geothermal properties of the taxpayer, the amount (if any) by which the amount of the excess intangible drilling costs arising in the taxable year is greater than 65 percent of the

net income of the taxpayer from oil, gas, and geothermal properties for the taxable year.

"(B) EXCESS INTANGIBLE DRILLING COSTS.—For purposes of subparagraph (A), the amount of the excess intangible drilling costs arising in the taxable year is the excess of—

"(i) the intangible drilling and development costs paid or incurred in connection with oil, gas, and geothermal wells (other than costs incurred in drilling a nonproductive well) allowable under section 263(c) or 291(b) for the taxable year, over

"(ii) the amount which would have been allowable for the taxable year if such costs had been capitalized and straight line recovery of intangibles (as defined in subsection (b)) had been used with respect to such costs.

"(C) NET INCOME FROM OIL, GAS, AND GEOTHERMAL PROPERTIES.—For purposes of subparagraph (A), the amount of the net income of the taxpayer from oil, gas, and geothermal properties for the taxable year is the excess of—

"(i) the aggregate amount of gross income (within the meaning of section 613(a)) from all oil, gas, and geothermal properties of the taxpayer received or accrued by the taxpayer during the taxable year, over

"(ii) the amount of any deductions allocable to such properties reduced by the excess described in subparagraph (B) for such taxable year.

"(D) PARAGRAPH APPLIED SEPARATELY WITH RESPECT TO GEOTHERMAL PROPERTIES AND OIL AND GAS PROPERTIES.—This paragraph shall be applied separately with respect to—

"(i) all oil and gas properties which are not described in clause (ii), and

"(ii) all properties which are geothermal deposits (as defined in section 613(e)(3)).

"(3) INCENTIVE STOCK OPTIONS.—

"(A) IN GENERAL.—With respect to the transfer of a share of stock pursuant to the exercise of an incentive stock option (as defined in section 422A), the amount by which the fair market value of the share at the time of exercise exceeds the option price. For purposes of this paragraph, the fair market value of a share of stock shall be determined without regard to any restriction other than a restriction which, by its terms, will never lapse.

"(B) BASIS ADJUSTMENT.—In determining the amount of gain or loss recognized for purposes of this part on any disposition of a share of stock acquired pursuant to an exercise (in a taxable year beginning after December 31, 1986) of an incentive stock option, the basis of such stock shall be increased by the amount of the excess referred to in subparagraph (A).

"(4) RESERVES FOR LOSSES ON BAD DEBTS OF FINANCIAL INSTITUTIONS.—In the case of a financial institution to which section 585 or 593 applies, the amount by which the deduction allowable for the taxable year for a reasonable addition to a reserve for bad debts exceeds the amount that would have been allow-

able had the institution maintained its bad debt reserve for all taxable years on the basis of actual experience.

"(5) TAX-EXEMPT INTEREST.—

"(A) IN GENERAL.—Interest on specified private activity bonds reduced by any deduction (not allowable in computing the regular tax) which would have been allowable if such interest were includible in gross income.

"(B) TREATMENT OF EXEMPT-INTEREST DIVIDENDS.—Under regulations prescribed by the Secretary, any exempt-interest dividend (as defined in section 852(b)(5)(A)) shall be treated as interest on a specified private activity bond to the extent of its proportionate share of the interest on such bonds received by the company paying such dividend.

"(C) SPECIFIED PRIVATE ACTIVITY BONDS.—

"(i) IN GENERAL.—For purposes of this part, the term 'specified private activity bonds' means any private activity bond (as defined in section 141) issued after August 7, 1986.

"(ii) EXCEPTION FOR QUALIFIED 501(C)(3) BONDS.—For purposes of clause (i), the term 'private activity bond' shall not include any qualified 501(c)(3) bond (as defined in section 145).

"(iii) EXCEPTION FOR REFUNDINGS.—For purposes of clause (i), the term 'private activity bond' shall not include any refunding bond if the refunded bond (or in the case of a series of refundings, the original bond) was issued before August 8, 1986.

"(iv) CERTAIN BONDS ISSUED BEFORE SEPTEMBER 1, 1986.—For purposes of this subparagraph, a bond issued before September 1, 1986, shall be treated as issued before August 8, 1986, unless such bond would be a private activity bond if—

"(I) paragraphs (1) and (2) of section 141(b) were applied by substituting '25 percent' for '10 percent' each place it appears,

"(II) paragraphs (3), (4), and (5) of section 141(b) did not apply, and

"(III) subparagraph (B) of section 141(c)(1) did not apply.

"(6) APPRECIATED PROPERTY CHARITABLE DEDUCTION.—

"(A) IN GENERAL.—The amount by which the deduction allowable under section 170 would be reduced if all capital gain property were taken into account at its adjusted basis.

"(B) CAPITAL GAIN PROPERTY.—For purposes of subparagraph (A), the term 'capital gain property' has the meaning given to such term by section 170(b)(1)(C)(iv). Such term shall not include any property to which an election under section 170(b)(1)(C)(iii) applies.

"(7) ACCELERATED DEPRECIATION OR AMORTIZATION ON CERTAIN PROPERTY PLACED IN SERVICE BEFORE JANUARY 1, 1987.—The amounts which would be treated as items of tax preference with respect to the taxpayer under paragraphs (2), (3), (4), and (12) of this subsection (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986). The preceding *sentence shall not apply to any property to which section 56(a)(1) or (5) applies.*

"(b) Straight Line Recovery of Intangibles Defined.—For purposes of paragraph (2) of subsection (a)—

"(1) In general.—The term 'straight line recovery of intangibles', when used with respect to intangible drilling and development costs for any well, means (except in the case of an election under paragraph (2)) ratable amortization of such costs over the 120-month period beginning with the month in which production from such well begins.

"(2) Election.—If the taxpayer elects with respect to the intangible drilling and development costs for any well, the term 'straight line recovery of intangibles' means any method which would be permitted for purposes of determining cost depletion with respect to such well and which is selected by the taxpayer for purposes of subsection (a)(2).

"SEC. 58. DENIAL OF CERTAIN LOSSES.

"(a) Denial of Farm Loss.—

"(1) In general.—For purposes of computing the amount of the alternative minimum taxable income for any taxable year of a taxpayer other than a corporation—

"(A) Disallowance of farm loss.—No loss of the taxpayer for such taxable year from any tax shelter farm activity shall be allowed.

"(B) Deduction in succeeding taxable year.—Any loss from a tax shelter farm activity disallowed under subparagraph (A) shall be treated as a deduction allocable to such activity in the 1st succeeding taxable year.

"(2) Tax shelter farm activity.—For purposes of this subsection, the term 'tax shelter farm activity' means—

"(A) any farming syndicate as defined in section 464(c) (as modified by section 461(i)(4)(A)), and

"(B) any other activity consisting of farming which is a passive activity (within the meaning of section 469(d), without regard to paragraph (1)(B) thereof).

"(3) Application to personal service corporations.—For purposes of paragraph (1), a personal service corporation (within the meaning of section 469(g)(1)(C)) shall be treated as a taxpayer other than a corporation.

"(b) Disallowance of Passive Activity Loss.—In computing the alternative minimum taxable income of the taxpayer for any taxable year, section 469 shall apply, except that in applying section 469—

"(1) the adjustments of section 56 shall apply,

"(2) any deduction to the extent such deduction is an item of tax preference under section 57(a) shall not be taken into account, and

"(3) the provisions of section 469(l) (relating to phase-in of disallowance) shall not apply.

"(c) Special Rules.—For purposes of this section—

"(1) Special rule for insolvent taxpayers.—

"(A) In general.—The amount of losses to which subsection (a) or (b) applies shall be reduced by the amount (if

any) by which the taxpayer is insolvent as of the close of the taxable year.

"(B) INSOLVENT.—For purposes of this paragraph, the term 'insolvent' means the excess of liabilities over the fair market value of assets.

"(2) LOSS ALLOWED FOR YEAR OF DISPOSITION OF FARM SHELTER ACTIVITY.—If the taxpayer disposes of his entire interest in any tax shelter farm activity during any taxable year, the amount of the loss attributable to such activity (determined after carryovers under subsection (a)(1)(B)) shall (to the extent otherwise allowable) be allowed for such taxable year in computing alternative minimum taxable income and not treated as a loss from a tax shelter farm activity.

"SEC. 59. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) ALTERNATIVE MINIMUM TAX FOREIGN TAX CREDIT.—For purposes of this part—

"(1) IN GENERAL.—The alternative minimum tax foreign tax credit for any taxable year shall be the credit which would be determined under section 27(a) for such taxable year if—

"(A) the amount determined under section 55(b)(1)(A) were the tax against which such credit was taken for purposes of section 904 for the taxable year and all prior taxable years beginning after December 31, 1986,

"(B) section 904 were applied on the basis of alternative minimum taxable income instead of taxable income, and

"(C) for purposes of section 904, any increase in alternative minimum taxable income by reason of section 56(c)(1)(A) (relating to adjustment for book income) shall have the same proportionate source (and character) as alternative minimum taxable income determined without regard to such increase.

"(2) LIMITATION TO 90 PERCENT OF TAX.—

"(A) IN GENERAL.—The alternative minimum tax foreign tax credit for any taxable year shall not exceed the excess (if any) of—

"(i) the amount determined under section 55(b)(1)(A) for the taxable year, over

"(ii) 10 percent of the amount which would be determined under section 55(b)(1)(A) without regard to the alternative tax net operating loss deduction.

"(B) CARRYBACK AND CARRYFORWARD.—If the alternative minimum tax foreign tax credit exceeds the amount determined under subparagraph (A), such excess shall, for purposes of this part, be treated as an amount to which section 904(c) applies.

"(b) MINIMUM TAX NOT TO APPLY TO INCOME ELIGIBLE FOR SECTION 936 CREDIT.—In the case of any corporation for which a credit is allowable for the taxable year under section 936, alternative minimum taxable income shall not include any amount with respect to which the requirements of subparagraph (A) or (B) of section 936(a)(1) are met.

"(c) TREATMENT OF ESTATES AND TRUSTS.—In the case of any estate or trust, the alternative minimum taxable income of such

estate or trust and any beneficiary thereof shall be determined by applying part I of subchapter J with the adjustments provided in this part.

"(d) Apportionment of Differently Treated Items in Case of Certain Entities.—

"(1) In general.—The differently treated items for the taxable year shall be apportioned (in accordance with regulations prescribed by the Secretary)—

"(A) Regulated investment companies and real estate investment trusts.—In the case of a regulated investment company to which part I of subchapter M applies or a real estate investment company to which part II of subchapter M applies, between such company or trust and shareholders and holders of beneficial interest in such company or trust.

"(B) Common trust funds.—In the case of a common trust fund (as defined in section 584(a)), pro rata among the participants of such fund.

"(2) Differently treated items.—For purposes of this section, the term 'differently treated item' means any item of tax preference or any other item which is treated differently for purposes of this part than for purposes of computing the regular tax.

"(e) Optional 10-Year Writeoff of Certain Tax Preferences.—

"(1) In general.—For purposes of this title, any qualified expenditure to which an election under this paragraph applies shall be allowed as a deduction ratably over the 10-year period (3-year period in the case of circulation expenditures described in section 173) beginning with the taxable year in which such expenditure was made.

"(2) Qualified expenditure.—For purposes of this subsection, the term 'qualified expenditure' means any amount which, but for an election under this subsection, would have been allowable as a deduction for the taxable year in which paid or incurred under—

"(A) section 173 (relating to circulation expenditures),

"(B) section 174(a) (relating to research and experimental expenditures),

"(C) section 263(c) (relating to intangible drilling and development expenditures),

"(D) section 616(a) (relating to development expenditures), or

"(E) section 617(a) (relating to mining exploration expenditures).

"(3) Other sections not applicable.—Except as provided in this subsection, no deduction shall be allowed under any other section for any qualified expenditure to which an election under this subsection applies.

"(4) Election.—

"(A) In general.—An election may be made under paragraph (1) with respect to any portion of any qualified expenditure.

"(B) REVOCABLE ONLY WITH CONSENT.—*Any election under this subsection may be revoked only with the consent of the Secretary.*

"(C) PARTNERS AND SHAREHOLDERS OF S CORPORATIONS.—*In the case of a partnership, any election under paragraph (1) shall be made separately by each partner with respect to the partner's allocable share of any qualified expenditure. A similar rule shall apply in the case of an S corporation and its shareholders.*

"(5) DISPOSITIONS.—

"(A) APPLICATION OF SECTION 1254.—*In the case of any disposition of property to which section 1254 applies (determined without regard to this section), any deduction under paragraph (1) with respect to amounts which are allocable to such property shall, for purposes of section 1254, be treated as a deduction allowable under section 263(c), 616(a), or 617(a), whichever is appropriate.*

"(B) APPLICATION OF SECTION 617(d).—*In the case of any disposition of mining property to which section 617(d) applies (determined without regard to this subsection), any deduction under paragraph (1) with respect to amounts which are allocable to such property shall, for purposes of section 617(d), be treated as a deduction allowable under section 617(a).*

"(6) AMOUNTS TO WHICH ELECTION APPLY NOT TREATED AS TAX PREFERENCE.—*Any portion of any qualified expenditure to which an election under paragraph (1) applies shall not be treated as an item of tax preference under section 57(a) and section 56 shall not apply to such expenditure.*

"(f) COORDINATION WITH SECTION 291.—*Except as otherwise provided in this part, section 291 (relating to cutback of corporate preferences) shall apply before the application of this part.*

"(g) TAX BENEFIT RULE.—*The Secretary may prescribe regulations under which differently treated items shall be properly adjusted where the tax treatment giving rise to such items will not result in the reduction of the taxpayer's regular tax for any taxable year.*

"(h) COORDINATION WITH CERTAIN LIMITATIONS.—*The limitations of sections 704(d), 465, and 1366(d) (and such other provisions as may be specified in regulations) shall be applied for purposes of computing the alternative minimum taxable income of the taxpayer for the taxable year—*

"(1) *with the adjustments of section 56, and*

"(2) *by not taking into account any deduction to the extent such deduction is an item of tax preference under section 57(a).*

"(i) SPECIAL RULE FOR INTEREST TREATED AS TAX PREFERENCE.—*For purposes of this subtitle, interest shall not fail to be treated as wholly exempt from tax imposed by this title solely by reason of being included in alternative minimum taxable income."*

(b) CREDIT AGAINST REGULAR TAX FOR PRIOR YEAR MINIMUM TAX LIABILITY.—*Part IV of subchapter A of chapter 1 (relating to credits allowable) is amended by adding at the end thereof the following new subpart:*

"Subpart G—Credit Against Regular Tax for Prior Year Minimum Tax Liability

"Sec. 53. Credit for prior year minimum tax liability.

"SEC. 53. CREDIT FOR PRIOR YEAR MINIMUM TAX LIABILITY.

"(a) ALLOWANCE OF CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for any taxable year an amount equal to the minimum tax credit for such taxable year.

"(b) MINIMUM TAX CREDIT.—For purposes of subsection (a), the minimum tax credit for any taxable year is the excess (if any) of—

"(1) the adjusted net minimum tax imposed for all prior taxable years beginning after 1986, over

"(2) the amount allowable as a credit under subsection (a) for such prior taxable years.

"(c) LIMITATION.—The credit allowable under subsection (a) for any taxable year shall not exceed the excess (if any) of—

"(1) the regular tax liability of the taxpayer for such taxable year reduced by the sum of the credits allowable under subparts A, B, D, E, and F of this part, over

"(2) the tentative minimum tax for the taxable year.

"(d) DEFINITIONS.—For purposes of this section—

"(1) NET MINIMUM TAX.—

"(A) IN GENERAL.—The term 'net minimum tax' means the tax imposed by section 55.

"(B) CREDIT NOT ALLOWED FOR EXCLUSION PREFERENCES.—

"(i) ADJUSTED NET MINIMUM TAX.—The adjusted net minimum tax for any taxable year is—

"(I) the amount of the net minimum tax for such taxable year, reduced by

"(II) the amount which would be the net minimum tax for such taxable year if the only adjustments and items of tax preference taken into account were those specified in clause (ii).

"(ii) SPECIFIED ITEMS.—The following are specified in this clause—

"(I) the adjustments provided for in subsections (b)(1) and (c)(3) of section 56, and

"(II) the items of tax preference described in paragraphs (1), (5), and (6) of section 57(a).

In the case of taxable years beginning after 1989, the adjustments provided in section 56(g) shall be treated as specified in this clause to the extent attributable to items which are excluded from gross income for any taxable year for purposes of the regular tax, or are not deductible for any taxable year under the adjusted earnings and profits method of section 56(g).

"(2) TENTATIVE MINIMUM TAX.—The term 'tentative minimum tax' has the meaning given to such term by section 55(b)."

(c) CREDITS NOT ALLOWABLE AGAINST MINIMUM TAX.—

(1) PERSONAL CREDITS.—

(A) IN GENERAL.—Subsection (a) of section 26 (relating to limitation based on amount of tax) is amended to read as follows:

"(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the excess (if any) of—

"(1) the taxpayer's regular tax liability for the taxable year, over

"(2) the tentative minimum tax for the taxable year (determined without regard to the alternative minimum tax foreign tax credit)."

(B) REGULAR TAX LIABILITY.—Subsection (b) of section 26 (as amended by title II) is amended—

(i) by striking out "this section" in the matter preceding paragraph (1) and inserting in lieu thereof "this part",

(ii) by striking out "tax liability" in paragraph (1) and inserting in lieu thereof "regular tax liability",

(iii) by striking out subparagraph (A) of paragraph (2) and inserting in lieu thereof the following:

"(A) section 55 (relating to minimum tax),",

(iv) by striking out "and" at the end of paragraph (2)(H), by striking out the period at the end of paragraph (2)(I) and inserting in lieu thereof ", and", and by adding at the end of paragraph (2) the following new subparagraph:

"(J) sections 871(a) and 881 (relating to certain income of nonresident aliens and foreign corporations,", and

(v) by striking out "TAX LIABILITY" in the subsection heading and inserting in lieu thereof "REGULAR TAX LIABILITY".

(C) TENTATIVE MINIMUM TAX.—Subsection (c) of section 26 is amended to read as follows:

"(c) TENTATIVE MINIMUM TAX.—For purposes of this part, the term 'tentative minimum tax' means the amount determined under section 55(b)(1)."

(2) CREDIT FOR CLINICAL TESTING EXPENSES.—Paragraph (2) of section 28(d) is amended to read as follows:

"(2) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed by this section for any taxable year shall not exceed the excess (if any) of—

"(A) the regular tax (reduced by the sum of the credits allowable under subpart A and section 27), over

"(B) the tentative minimum tax for the taxable year."

(3) CREDIT FOR PRODUCTION OF FUEL FROM NONCONVENTIONAL SOURCES.—Paragraph (5) of section 29(b) is amended to read as follows:

"(5) APPLICATION WITH OTHER CREDITS.—The credit allowed by subsection (a) for any taxable year shall not exceed the excess (if any) of—

"(A) the regular tax for the taxable year reduced by the sum of the credits allowable under subpart A and sections 27 and 28, over

"(B) the tentative minimum tax for the taxable year."

(4) GENERAL BUSINESS CREDIT.—Subsection (c) of section 38 (relating to limitation based on amount of tax), as amended by section 631(a), is amended by redesignating paragraph (3) as paragraph (4), and by striking out paragraphs (1) and (2) and inserting in lieu thereof the following:

"(1) IN GENERAL.—The credit allowed under subsection (a) for any taxable year shall not exceed the lesser of—

"(A) the allowable portion of the taxpayer's net regular tax liability for the taxable year, or

"(B) the excess (if any) of the taxpayer's net regular tax liability for the taxable year over the tentative minimum tax for the taxable year.

"(2) ALLOWABLE PORTION OF NET REGULAR TAX LIABILITY.—For purposes of this subsection, the allowable portion of the taxpayer's net regular tax liability for the taxable year is the sum of—

"(A) so much of the taxpayer's net regular tax liability for the taxable year as does not exceed $25,000, plus

"(B) 75 percent of so much of the taxpayer's net regular tax liability for the taxable year as exceeds $25,000.

For purposes of the preceding sentence, the term 'net regular tax liability' means the regular tax liability reduced by the sum of the credits allowable under subparts A and B of this part.

"(3) REGULAR INVESTMENT TAX CREDIT MAY OFFSET 25 PERCENT OF MINIMUM TAX.—In the case of any C corporation, to the extent the credit under subsection (a) is attributable to the application of the regular percentage under section 46, the limitation of paragraph (1) shall be the greater of—

"(A) the lesser of—

"(i) the allowable portion of the taxpayer's net regular tax liability for the taxable year, or

"(ii) the excess (if any) of the taxpayer's net regular tax liability for the taxable year over 75 percent of the tentative minimum tax for the taxable year, or

"(B) 25 percent of the taxpayer's tentative minimum tax for the year."

In no event shall this paragraph permit the allowance of a credit which (in combination with the alternative tax net operating loss deduction and the alternative minimum tax foreign tax credit) would reduce the tax payable under section 55 below an amount equal to 10 percent of the amount which would be determined under section 55(b) without regard to the alternative tax net operating loss deduction and the alternative minimum tax foreign tax credit."

(d) ESTIMATED TAX PROVISIONS TO APPLY TO CORPORATE MINIMUM TAX.—

(1) Paragraph (1) of section 6154(c) is amended to read as follows:

"(1) The amount which the corporation estimates as the sum of—

"(A) the income tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever applies, and

"(B) the minimum tax imposed by section 55, over".

(2) Subparagraph (A) of section 6425(c)(1) is amended to read as follows:

"(A) The sum of—

"(i) the tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever is applicable, plus

"(ii) the tax imposed by section 55, over".

(3) Paragraph (1) of section 6655(f) is amended to read as follows:

"(1) the sum of—

"(A) the tax imposed by section 11 or 1201(a), or subchapter L of chapter 1, whichever is applicable, plus

"(B) the tax imposed by section 55, over".

(e) TECHNICAL AMENDMENTS.—

(1) APPLICATION OF SECTION 381.—Subsection (c) of section 381 is amended by adding at the end thereof the following new paragraph:

"(27) CREDIT UNDER SECTION 53.—The acquiring corporation shall take into account (to the extent proper to carry out the purposes of this section and section 53, and under such regulations as may be prescribed by the Secretary) the items required to be taken into account for purposes of section 53 in respect of the distributor or transferor corporation."

(2) LIMITATION IN CASE OF CONTROLLED CORPORATIONS.—Subsection (a) of section 1561 (relating to limitations on certain multiple tax benefits in the case of certain controlled corporations) is amended—

(A) by striking out "and" at the end of paragraph (1), by striking out the period at the end of paragraph (2) and inserting in lieu thereof ", and" and by inserting after paragraph (2) the following new paragraph:

"(3) one $40,000 exemption amount for purposes of computing the amount of the minimum tax.",

(B) by striking out "amounts specified in paragraph (1)" and inserting in lieu thereof "amounts specified in paragraph (1) (and the amount specified in paragraph (3))", and

(C) by adding at the end thereof the following new sentence: "In applying section 55(d)(3), the alternative minimum taxable income of all component members shall be taken into account and any decrease in the exemption amount shall be allocated to the component members in the same manner as under paragraph (3)."

(3) TREATMENT OF SHORT TAXABLE YEARS.—Subsection (d) of section 443 (relating to adjustment in computing minimum tax for tax preference) is amended to read as follows:

"(d) ADJUSTMENT IN COMPUTING MINIMUM TAX AND TAX PREFERENCES.—If a return is made for a short period by reason of subsection (a)—

"(1) the alternative minimum taxable income for the short period shall be placed on an annual basis by multiplying such amount by 12 and dividing the result by the number of months in the short period, and

"(2) the amount computed under paragraph (1) of section 55(a) shall bear the same relation to the tax computed on the

annual basis as the number of months in the short period bears to 12."

(4) Conforming amendments.—

(A) Paragraph (4) of section 5(a) is amended to read as follows:

"(4) For alternative minimum tax, see section 55."

(B) Paragraph (7) of section 12 is amended to read as follows:

"(7) For alternative minimum tax, see section 55."

(C) Subparagraph (D) of section 48(d)(4) is amended by striking out "section 57(c)(1)(B)" and inserting in lieu thereof "section 57(c)(1)(B) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)".

(D) Section 173(b), 174(e)(2), 263(c), and 1016(a)(24) (as redesignated by section 634(b)(2)) are each amended by striking out "section 58(i)" and inserting in lieu thereof "section 59(d)".

(E) Subsection (b) of section 703 (relating to elections of the partnership), as amended by title V, is amended by striking out paragraph (1) and by redesignating paragraphs (2) through (4) as paragraphs (1) through (3), respectively.

(F) Paragraph (1) of section 882(a) (relating to imposition of tax on income of foreign corporations connected with United States business) is amended by striking out "or 1201(a)" and inserting in lieu thereof ", 55, or 1201(a)".

(G) So much of section 897(a)(2) as precedes subparagraph (B) thereof is amended to read as follows:

"(2) 21-PERCENT MINIMUM TAX ON NONRESIDENT ALIEN INDIVIDUALS.—

"(A) In general.—In the case of any nonresident alien individual, the amount determined under section 55(b)(1)(A) shall not be less than 21 percent of the lesser of—

"(i) the individual's alternative minimum taxable income (as defined in section 55(b)(2)) for the taxable year, or

"(ii) the individual's net United States real property gain for the taxable year."

(H) Paragraph (2) of section 904(i) (relating to cross references) is amended by striking out "by an individual" and all that follows and inserting in lieu thereof "against the alternative minimum tax, see section 59(a)."

(I) Paragraph (3) of section 936(a) is amended by striking out subparagraph (A) and by redesignating subparagraphs (B), (C), and (E) as subparagraphs (A), (B), and (C), respectively.

(J) Subsection (a) of section 1363 is amended by striking out "and in section 58(d)".

(K) Paragraph (2) of section 1366(f) (relating to reduction in pass-thru for tax imposed on capital gain) is amended by striking out "56 or".

(f) Effective Dates.—

(1) In general.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Adjustment of net operating loss.—

(A) Individuals.—In the case of a net operating loss of an individual for a taxable year beginning after December 31, 1982, and before January 1, 1987, for purposes of determining the amount of such loss which may be carried to a taxable year beginning after December 31, 1986, for purposes of the minimum tax, such loss shall be adjusted in the manner provided in section 55(d)(2) of the Internal Revenue Code of 1954 as in effect on the day before the date of the enactment of this Act.

(B) Corporations.—If the minimum tax of a corporation was deferred under section 56(b) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) for any taxable year beginning before January 1, 1987, and the amount of such tax has not been paid for any taxable year beginning before January 1, 1987, the amount of the net operating loss carryovers of such corporation which may be carried to taxable years beginning after December 31, 1986, for purposes of the minimum tax shall be reduced by the amount of tax preferences a tax on which was so deferred.

(3) Installment sales.—Section 56(a)(6) of the Internal Revenue Code of 1986 (as amended by this section) shall not apply to any disposition to which the amendments made by section 811 of this Act (relating to allocation of dealer's indebtedness to installment obligations) do not apply by reason of section 811(c)(2) of this Act.

(4) Exception for charitable contributions before August 16, 1986.—Section 57(a)(6) of the Internal Revenue Code of 1986 (as amended by this section) shall not apply to any deduction attributable to contributions made before August 16, 1986.

(5) Book income.—

(A) In general.—In the case of a corporation to which this paragraph applies, the amount of any increase for any taxable year under section 56(c)(1)(A) of the Internal Revenue Code of 1986 (as added by this section) shall be reduced (but not below zero) by the excess (if any) of—

(i) 50 percent of the excess of taxable income for the 5-taxable year period ending with the taxable year preceding the 1st taxable year to which such section applies over the adjusted net book income for such period, over

(ii) the aggregate amounts taken into account under this paragraph for preceding taxable years.

(B) Taxpayer to whom paragraph applies.—This paragraph applies to a taxpayer which was incorporated in Delaware on May 31, 1912.

(C) Terms.—Any term used in this paragraph which is used in section 56 of such Code (as so added) shall have the same meaning as when used in such section.

(6) CERTAIN PUBLIC UTILITY.—

(A) In the case of investment tax credits described in subparagraph (B) or (C), subsection 38(c)(3)(A)(ii) of the Internal Revenue Code of 1986 shall be applied by substituting "25 percent" for "75 percent", and section 38(c)(3)(B) of the Internal Revenue Code of 1986 shall be applied by substituting "75 percent" for "25 percent".

(B) If, on September 25, 1985, a regulated electric utility owned an undivided interest, within the range of 1,111 and 1,149, in the "maximum dependable capacity, net, megawatts electric" of an electric generating unit located in Illinois or Mississippi for which a binding written contract was in effect on December 31, 1980, then any investment tax credit with respect to such unit shall be described in this subparagraph. The aggregate amount of investment tax credits with respect to the unit in Mississippi allowed solely by reason of being described in this subparagraph shall not exceed $141,000,000.

(C) If, on September 25, 1985, a regulated electric utility owned an undivided interest, within the range of 1,104 and 1,111, in the "maximum dependable capacity, net, megawatts electric" of an electric generating unit located in Louisiana for which a binding written contract was in effect on December 31, 1980, then any investment tax credit of such electric utility shall be described in this subparagraph. The aggregate amount of investment tax credits allowed solely by reason of being described by this subparagraph shall not exceed $20,000,000.

(7) AGREEMENT VESSEL DEPRECIATION ADJUSTMENT.—

(A) For purposes of part VI of subchapter A of chapter 1 of the Internal Revenue Code of 1986, in the case of a qualified taxpayer, alternative minimum taxable income for the taxable year shall be reduced by an amount equal to the agreement vessel depreciation adjustment.

(B) For purposes of this paragraph, the agreement vessel depreciation adjustment shall be an amount equal to the depreciation deduction that would have been allowable for such year under section 167 of such Code with respect to agreement vessels placed in service before January 1, 1987, if the basis of such vessels had not been reduced under section 607 of the Merchant Marine Act of 1936, as amended, and if depreciation with respect to such vessel had been computed using the 25-year straight-line method. The aggregate amount by which basis of a qualified taxpayer is treated as not reduced by reason of this subparagraph shall not exceed $100,000,000.

(C) For purposes of this paragraph, the term "qualified taxpayer" means a parent corporation incorporated in the State of Delaware on December 1, 1972, and engaged in water transportation, and includes any other corporation which is a member of the affiliated group of which the parent corporation is the common parent. No taxpayer shall be treated as a qualified corporation for any taxable year beginning after December 31, 1991.

SEC. 702. STUDY OF BOOK AND EARNINGS AND PROFITS ADJUSTMENTS.

The Secretary of the Treasury or his delegate shall conduct a study of the operation and effect of the provisions of sections 56(f) and 56(g) of the Internal Revenue Code of 1986.

TITLE VIII—ACCOUNTING PROVISIONS

Subtitle A—General Provisions

SEC. 801. LIMITATION ON USE OF CASH METHOD OF ACCOUNTING.

(a) General Rule.—Subpart A of part II of subchapter E of chapter 1 (relating to methods of accounting) is amended by adding at the end thereof the following new section:

"SEC. 448. LIMITATION ON USE OF CASH METHOD OF ACCOUNTING.

"(a) General Rule.—Except as otherwise provided in this section, in the case of a—

"(1) C corporation,

"(2) partnership which has a C corporation as a partner, or

"(3) tax shelter,

taxable income shall not be computed under the cash receipts and disbursements method of accounting.

"(b) Exceptions.—

"(1) Farming business.—Paragraphs (1) and (2) of subsection (a) shall not apply to any farming business.

"(2) Qualified personal service corporations.—Paragraphs (1) and (2) of subsection (a) shall not apply to a qualified personal service corporation, and such a corporation shall be treated as an individual for purposes of determining whether paragraph (2) of subsection (a) applies to any partnership.

"(3) Entities with gross receipts of not more than $5,000,000.—Paragraphs (1) and (2) of subsection (a) shall not apply to any corporation or partnership for any taxable year if, for all prior taxable years beginning after December 31, 1985, such entity (or any predecessor) met the $5,000,000 gross receipts test of subsection (c).

"(c) $5,000,000 Gross Receipts Test.—For purposes of this section—

"(1) In general.—A corporation or partnership meets the $5,000,000 gross receipts test of this subsection for any prior taxable year if the average annual gross receipts of such entity for the 3-taxable-year period ending with such prior taxable year does not exceed $5,000,000.

"(2) Aggregation rules.—All persons treated as a single employer under subsection (a) or (b) of section 52 or subsection (m) or (o) of section 414 shall be treated as one person for purposes of paragraph (1).

"(3) Special rules.—For purposes of this subsection—

"(A) Not in existence for entire 3-year period.—If the entity was not in existence for the entire 3-year period referred to in paragraph (1), such paragraph shall be applied on the basis of the period during which such entity (or trade or business) was in existence.

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"(B) SHORT TAXABLE YEARS.—Gross receipts for any taxable year of less than 12 months shall be annualized by multiplying the gross receipts for the short period by 12 and dividing the result by the number of months in the short period.

"(C) GROSS RECEIPTS.—Gross receipts for any taxable year shall be reduced by returns and allowances made during such year.

"(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) FARMING BUSINESS.—

"(A) IN GENERAL.—The term 'farming business' means the trade or business of farming (within the meaning of section 263A(e)(4)).

"(B) TIMBER AND ORNAMENTAL TREES.—The term 'farming business' includes the raising, harvesting, or growing of trees to which section 263A(c)(5) applies.

"(2) QUALIFIED PERSONAL SERVICE CORPORATION.—The term 'qualified personal service corporation' means any corporation—

"(A) substantially all of the activities of which involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and

"(B) substantially all of the stock of which (by value) is held directly or indirectly by—

"(i) employees performing services for such corporation in connection with the activities involving a field referred to in subparagraph (A),

"(ii) retired employees who had performed such services for such corporation,

"(iii) the estate of any individual described in clause (i) or (ii), or

"(iv) any other person who acquired such stock by reason of the death of an individual described in clause (i) or (ii) (but only for the 2-year period beginning on the date of the death of such individual).

"(3) TAX SHELTER DEFINED.—The term 'tax shelter' has the meaning given such term by section 461(i)(3) (determined after application of paragraph (4) thereof).

"(4) SPECIAL RULES FOR APPLICATION OF PARAGRAPH (2).—For purposes of paragraph (2)—

"(A) community property laws shall be disregarded,

"(B) stock held by a plan described in section 401(a) which is exempt from tax under section 501(a) shall be treated as held by an employee described in paragraph (2)(B)(i), and

"(C) at the election of the common parent of an affiliated group (within the meaning of section 1504(a)), all members of such group may be treated as 1 taxpayer for purposes of paragraph (2)(B) if substantially all of the activities of all such members involve the performance of services in the same field described in paragraph (2)(A).

"(5) SPECIAL RULE FOR SERVICES.—In the case of any person using an accrual method of accounting with respect to amounts

to be received for the performance of services by such person, such person shall not be required to accrue any portion of such amounts which (on the basis of experience) will not be collected. This paragraph shall not apply to any amount if interest is required to be paid on such amount or there is any penalty for failure to timely pay such amount.

"(6) TREATMENT OF CERTAIN TRUSTS SUBJECT TO TAX ON UNRELATED BUSINESS INCOME.—For purposes of this section, a trust subject to tax under section 511(b) shall be treated as a C corporation with respect to its activities constituting an unrelated trade or business.

"(7) COORDINATION WITH SECTION 481.—In the case of any taxpayer required by this section to change its method of accounting for any taxable year—

"(A) such change shall be treated as initiated by the taxpayer,

"(B) such change shall be treated as made with the consent of the Secretary, and

"(C) the period for taking into account the adjustments under section 481 by reason of such change—

"(i) except as provided in clause (ii), shall not exceed 4 years, and

"(ii) in the case of a hospital, shall be 10 years."

(b) COORDINATION WITH APPLICATION OF ECONOMIC PERFORMANCE RULES TO TAX SHELTERS.—

(1) IN GENERAL.—So much of section 461(i) as precedes paragraph (3) thereof is amended to read as follows:

"(i) SPECIAL RULES FOR TAX SHELTERS.—

"(1) RECURRING ITEM EXCEPTION NOT TO APPLY.—In the case of a tax shelter, economic performance shall be determined without regard to paragraph (3) of subsection (h).

"(2) SPECIAL RULE FOR SPUDDING OF OIL OR GAS WELLS.—In the case of a tax shelter, economic performance with respect to the act of drilling an oil or gas well shall be treated as having occurred within a taxable year if drilling of the well commences before the close of the 90th day after the close of the taxable year."

(2) CONFORMING AMENDMENT.—Paragraph (4) of section 461(i) is amended to read as follows:

"(4) SPECIAL RULES FOR FARMING.—In the case of the trade or business of farming (as defined in section 464(e)), in determining whether an entity is a tax shelter, the definition of farming syndicate in section 464(c) shall be substituted for subparagraphs (A) and (B) of paragraph (3)."

(c) CLERICAL AMENDMENT.—The table of sections for subpart A of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 448. Limitation on use of cash method of accounting."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Election to retain cash method for certain transactions.—A taxpayer may elect not to have the amendments made by this section apply to any loan or lease, or any transaction with a related party (within the meaning of section 267(b) of the Internal Revenue Code of 1954, as in effect before the enactment of this Act), entered into on or before September 25, 1985. Any election under the preceding sentence may be made separately with respect to each transaction.

(3) Certain contracts.—The Amendments made by this section shall not apply to—

(A) contracts for the acquisition or transfer of real property, and

(B) contracts for services related to the acquisition or development of real property,

but only if such contracts were entered into before September 25, 1985, and the sole element of the contract which has not been performed as of September 25, 1985, is payment for such property or services.

(4) Treatment of affiliated group providing engineering services.—Each member of an affiliated group of corporations (within the meaning of section 1504(a) of the Internal Revenue Code of 1986) shall be allowed to use the cash receipts and disbursements method of accounting for any trade or business of provding engineering services with respect to taxable years ending after December 31, 1986, if the common parent of such group—

(A) was incorporated in the State of Delaware in 1970,

(B) was the successor to a corporation that was incorporated in the State of Illinois in 1949, and

(C) used the completed contract method of accounting for a substantial part of its income from the performance of engineering services.

SEC. 802. SIMPLIFIED DOLLAR-VALUE LIFO METHOD FOR CERTAIN SMALL BUSINESSES.

(a) General Rule.—Section 474 (relating to election by certain small businesses to use one inventory pool) is amended to read as follows:

"SEC. 474. SIMPLIFIED DOLLAR-VALUE LIFO METHOD FOR CERTAIN SMALL BUSINESSES.

"(a) General Rule.—An eligible small business may elect to use the simplified dollar-value method of pricing inventories for purposes of the LIFO method.

"(b) Simplified Dollar-Value Method of Pricing Inventories.—For purposes of this section—

"(1) In general.—The simplified dollar-value method of pricing inventories is a dollar-value method of pricing inventories under which—

"(A) the taxpayer maintains a separate inventory pool for items in each major category in the applicable Government price index, and

"(B) the adjustment for each such separate pool is based on the change from the preceding taxable year in the component of such index for the major category.

"(2) APPLICABLE GOVERNMENT PRICE INDEX.—The term 'applicable Government price index' means—

"(A) except as provided in subparagraph (B), the Producer Price Index published by the Bureau of Labor Statistics, or

"(B) in the case of a retailer using the retail method, the Consumer Price Index published by the Bureau of Labor Statistics.

"(3) MAJOR CATEGORY.—The term 'major category' means—

"(A) in the case of the Producer Price Index, any of the 2-digit standard industrial classifications in the Producer Prices Data Report, or

"(B) in the case of the Consumer Price Index, any of the general expenditure categories in the Consumer Price Index Detailed Report.

"(c) ELIGIBLE SMALL BUSINESS.—For purposes of this section, a taxpayer is an eligible small business for any taxable year if the average annual gross receipts of the taxpayer for the 3 preceding taxable years do not exceed $5,000,000. For purposes of the preceding sentence, rules similar to the rules of section 448(c)(3) shall apply.

"(d) SPECIAL RULES.—For purposes of this section—

"(1) CONTROLLED GROUPS.—

"(A) IN GENERAL.—In the case of a taxpayer which is a member of a controlled group, all persons which are component members of such group shall be treated as 1 taxpayer for purposes of determining the gross receipts of the taxpayer.

"(B) CONTROLLED GROUP DEFINED.—For purposes of subparagraph (A), persons shall be treated as being component members of a controlled group if such persons would be treated as a single employer under section 52.

"(2) ELECTION.—

"(A) IN GENERAL.—The election under this section may be made without the consent of the Secretary.

"(B) PERIOD TO WHICH ELECTION APPLIES.—The election under this section shall apply—

"(i) to the taxable year for which it is made, and

"(ii) to all subsequent taxable years for which the taxpayer is an eligible small business,

unless the taxpayer secures the consent of the Secretary to the revocation of such election.

"(3) LIFO METHOD.—The term 'LIFO method' means the method provided by section 472(b).

"(4) TRANSITIONAL RULES.—

"(A) IN GENERAL.—In the case of a year of change under this section—

"(i) the inventory pools shall—

"(I) in the case of the 1st taxable year to which such an election applies, be established in accordance with the major categories in the applicable Government price index, or

"(II) in the case of the 1st taxable year after such election ceases to apply, be established in the manner provided by regulations under section 472;

"(ii) the aggregate dollar amount of the taxpayer's inventory as of the beginning of the year of change shall be the same as the aggregate dollar value as of the close of the taxable year preceding the year of change, and

"(iii) the year of change shall be treated as a new base year in accordance with procedures provided by regulations under section 472.

"(B) YEAR OF CHANGE.—For purposes of this paragraph, the year of change under this section is—

"(i) the 1st taxable year to which an election under this section applies, or

"(ii) in the case of a cessation of such an election, the 1st taxable year after such election ceases to apply."

(b) CLERICAL AMENDMENT.—The table of sections for subpart D of part II of subchapter E of chapter 1 is amended by striking out the item relating to section 474 and inserting in lieu thereof the following:

"Sec. 474. Simplified dollar-value LIFO method for certain small businesses."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) TREATMENT OF TAXPAYERS WHO MADE ELECTIONS UNDER EXISTING SECTION 474.—The amendments made by this section shall not apply to any taxpayer who made an election under section 474 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) for any period during which such election is in effect. Notwithstanding any provision of such section 474 (as so in effect), an election under such section may be revoked without the consent of the Secretary.

SEC. 803. CAPITALIZATION AND INCLUSION IN INVENTORY COSTS OF CERTAIN EXPENSES.

(a) GENERAL RULE.—Part IX of subchapter B of chapter 1 (relating to items not deductible) is amended by inserting after section 263 the following new section:

"SEC. 263A. CAPITALIZATION AND INCLUSION IN INVENTORY COSTS OF CERTAIN EXPENSES.

"(a) NONDEDUCTIBILITY OF CERTAIN DIRECT AND INDIRECT COSTS.—

"(1) IN GENERAL.—In the case of any property to which this section applies, any costs described in paragraph (2)—

"(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and

"(B) in the case of any other property, shall be capitalized.

"(2) ALLOCABLE COSTS.—The costs described in this paragraph with respect to any property are—

"(A) the direct costs of such property, and

"(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

"(b) Property to Which Section Applies.—Except as otherwise provided in this section, this section shall apply to—

"(1) Property produced by taxpayer.—Real or tangible personal property produced by the taxpayer.

"(2) Property acquired for resale.—

"(A) In general.—Real or personal property described in section 1221(1) which is acquired by the taxpayer for resale.

"(B) Exception for taxpayer with gross receipts of $10,000,000 or less.—Subparagraph (A) shall not apply to any personal property acquired during any taxable year by the taxpayer for resale if the average annual gross receipts of the taxpayer (or any predecessor) for the 3-taxable year period ending with the taxable year preceding such taxable year do not exceed $10,000,000.

"(C) Aggregation rules, etc.—For purposes of subparagraph (B), rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply.

For purposes of paragraph (1), the term 'tangible personal property' shall include a film, sound recording, video tape, book, or similar property.

"(c) General Exceptions.—

"(1) Personal use property.—This section shall not apply to any property produced by the taxpayer for use by the taxpayer other than in a trade or business or an activity conducted for profit.

"(2) Research and experimental expenditures.—This section shall not apply to any amount allowable as a deduction under section 174.

"(3) Certain development and other costs of oil and gas wells or other mineral property.—This section shall not apply to any cost allowable as a deduction under section 263(c), 616(a), or 617(a).

"(4) Coordination with long-term contract rules.—This section shall not apply to any property produced by the taxpayer pursuant to a long-term contract.

"(5) Timber and certain ornamental trees.—This section shall not apply to—

"(A) trees raised, harvested, or grown by the taxpayer other than trees described in clause (ii) of subsection (e)(4)(B) (after application of the last sentence thereof), and

"(B) any real property underlying such trees.

"(d) Exception for Farming Businesses.—

"(1) Section to apply only if preproductive period is more than 2 years.—

"(A) In general.—This section shall not apply to any plant or animal which is produced by the taxpayer in a farming business and which has a preproductive period of 2 years or less.

"(B) Exception for taxpayers required to use accrual method.—Subparagraph (A) shall not apply to any cor-

poration, partnership, or tax shelter required to use an accrual method of accounting under section 447 or 448(a)(3).

"(2) TREATMENT OF CERTAIN PLANTS LOST BY REASON OF CASUALTY.—

"(A) IN GENERAL.—If plants bearing an edible crop for human consumption were lost or damaged (while in the hands of the taxpayer) by reason of freezing temperatures, disease, drought, pests, or casualty, this section shall not apply to any costs of the taxpayer of replanting plants bearing the same type of crop (whether on the same parcel of land on which such lost or damaged plants were located or any other parcel of land of the same acreage in the United States).

"(B) SPECIAL RULE FOR PERSON WITH MINORITY INTEREST WHO MATERIALLY PARTICIPATES.—Subparagraph (A) shall apply to amounts paid or incurred by a person (other than the taxpayer described in subparagraph (A)) if—

"(i) the taxpayer described in subparagraph (A) has an equity interest of more than 50 percent in such grove, orchard, or vineyard, and

"(ii) such other person holds any part of the remaining equity interest and materially participates in the planting, maintenance, cultivation, or development of such grove, orchard, or vineyard during the 4-taxable year period beginning with the taxable year in which the grove, orchard or vineyard was lost or damaged.

The determination of whether an individual materially participates in any activity shall be made in a manner similar to the manner in which such determination is made under section 2032A(e)(6).

"(3) ELECTION TO HAVE THIS SECTION NOT APPLY.—

"(A) IN GENERAL.—If a taxpayer makes an election under this paragraph, this section shall not apply to any plant or animal produced in any farming business carried on by such taxpayer.

"(B) CERTAIN PERSONS NOT ELIGIBLE.—No election may be made under this paragraph—

"(i) by a corporation, partnership, or tax shelter, if such corporation, partnership, or tax shelter is required to use an accrual method of accounting under section 447 or 448(a)(3), or

"(ii) with respect to the planting, cultivation, maintenance, or development of pistachio trees.

"(C) SPECIAL RULE FOR CITRUS AND ALMOND GROWERS.—An election under this paragraph shall not apply with respect to any item which is attributable to the planting, cultivation, maintenance, or development of any citrus or almond grove (or part thereof) and which is incurred before the close of the 4th taxable year beginning with the taxable year in which the trees were planted. For purposes of the preceding sentence, the portion of a citrus or almond grove planted in 1 taxable year shall be treated separately from the portion of such grove planted in another taxable year.

"(D) ELECTION.—Unless the Secretary otherwise consents, an election under this paragraph may be made only for the taxpayer's 1st taxable year which begins after December 31, 1986, and during which the taxpayer engages in a farming business. Any such election, once made, may be revoked only with the consent of the Secretary.

"(e) DEFINITIONS AND SPECIAL RULES FOR PURPOSES OF SUBSECTION (d).—

"(1) RECAPTURE OF EXPENSED AMOUNTS ON DISPOSITION.—

"(A) IN GENERAL.—In the case of any plant or animal with respect to which amounts would have been capitalized under subsection (a) but for an election under subsection (d)(3)—

"(i) such plant or animal (if not otherwise section 1245 property) shall be treated as section 1245 property, and

"(ii) for purposes of section 1245, the recapture amount shall be treated as a deduction allowed for depreciation with respect to such property.

"(B) RECAPTURE AMOUNT.—For purposes of subparagraph (A), the term 'recapture amount' means any amount allowable as a deduction to the taxpayer which, but for an election under subsection (d)(3), would have been capitalized with respect to the plant or animal.

"(2) EFFECTS OF ELECTION ON DEPRECIATION.—

"(A) IN GENERAL.—If the taxpayer (or any related person) makes an election under subsection (d)(3), the provisions of section 168(g)(2) (relating to alternative depreciation) shall apply to all property of the taxpayer used predominantly in the farming business and placed in service in any taxable year during which any such election is in effect.

"(B) RELATED PERSON.—For purposes of subparagraph (A), the term 'related person' means—

"(i) the taxpayer and members of the taxpayer's family,

"(ii) any corporation (including an S corporation) if 50 percent or more (in value) of the stock of such corporation is owned (directly or through the application of section 318) by the taxpayer or members of the taxpayer's family,

"(iii) a corporation and any other corporation which is a member of the same controlled group described in section 1563(a)(1), and

"(iv) any partnership if 50 percent or more (in value) of the interests in such partnership is owned directly or indirectly by the taxpayer or members of the taxpayer's family.

"(C) MEMBERS OF FAMILY.—For purposes of this paragraph, the term 'family' means the taxpayer, the spouse of the taxpayer, and any of their children who have not attained age 18 before the close of the taxable year.

"(3) PREPRODUCTIVE PERIOD.—

"(A) IN GENERAL.—For purposes of this section, the term 'preproductive period' means—

"(i) in the case of a plant or animal which will have more than 1 crop or yield, the period before the 1st marketable crop or yield from such plant or animal, or

"(ii) in the case of any other plant or animal, the period before such plant or animal is reasonably expected to be disposed of.

For purposes of this subparagraph, use by the taxpayer in a farming business of any supply produced in such business shall be treated as a disposition.

"(B) RULE FOR DETERMINING PERIOD.—In the case of a plant grown in commercial quantities in the United States, the preproductive period for such plant if grown in the United States shall be based on the nationwide weighted average preproductive period for such plant.

"(4) FARMING BUSINESS.—For purposes of this section—

"(A) IN GENERAL.—The term 'farming business' means the trade or business of farming.

"(B) CERTAIN TRADES AND BUSINESSES INCLUDED.—The term 'farming business' shall include the trade or business of—

"(i) operating a nursery or sod farm, or

"(ii) the raising or harvesting of trees bearing fruit, nuts, or other crops, or ornamental trees.

For purposes of clause (ii), an evergreen tree which is more than 6 years old at the time severed from the roots shall not be treated as an ornamental tree.

"(5) CERTAIN INVENTORY VALUATION METHODS PERMITTED.—The Secretary shall by regulations permit the taxpayer to use reasonable inventory valuation methods to compute the amount required to be capitalized under subsection (a) in the case of any plant or animal.

"(f) SPECIAL RULES FOR ALLOCATION OF INTEREST TO PROPERTY PRODUCED BY THE TAXPAYER.—

"(1) INTEREST CAPITALIZED ONLY IN CERTAIN CASES.—Subsection (a) shall only apply to interest costs which are—

"(A) paid or incurred during the production period, and

"(B) allocable to property which is described in subsection (b)(1) and which has—

"(i) a long useful life,

"(ii) an estimated production period exceeding 2 years, or

"(iii) an estimated production period exceeding 1 year and a cost exceeding $1,000,000.

"(2) ALLOCATION RULES.—

"(A) IN GENERAL.—In determining the amount of interest required to be capitalized under subsection (a) with respect to any property—

"(i) interest on any indebtedness directly attributable to production expenditures with respect to such property shall be assigned to such property, and

"(ii) interest on any other indebtedness shall be assigned to such property to the extent that the taxpayer's interest costs could have been reduced if production ex-

penditures (not attributable to indebtedness described in clause (i)) had not been incurred.

"(B) Exception for qualified residence interest.—Subparagraph (A) shall not apply to any qualified residence interest (within the meaning of section 163(h)).

"(C) Special rule for flow-through entities.—Except as provided in regulations, in the case of any flow-through entity, this paragraph shall be applied first at the entity level and then at the beneficiary level.

"(3) Interest relating to property used to produce property.—This subsection shall apply to any interest on indebtedness incurred or continued in connection with property used to produce property to which this subsection applies to the extent such interest is allocable to the produced property.

"(4) Definitions.—For purposes of this subsection—

"(A) Long useful life.—Property has a long useful life if such property is—

"(i) real property, or

"(ii) property with a class life of 20 years or more (as determined under section 168).

"(B) Production period.—The term 'production period' means, when used with respect to any property, the period—

"(i) beginning on the date on which production of the property begins, and

"(ii) ending on the date on which the property is ready to be placed in service or is ready to be held for sale.

"(C) Production expenditures.—The term 'production expenditures' means the costs (whether or not incurred during the production period) required to be capitalized under subsection (a) with respect to the property.

"(g) Production.—For purposes of this section—

"(1) In general.—The term 'produce' includes construct, build, install, manufacture, develop, or improve.

"(2) Treatment of property produced under contract for the taxpayer.—The taxpayer shall be treated as producing any property produced for the taxpayer under a contract with the taxpayer; except that only costs paid or incurred by the taxpayer (whether under such contract or otherwise) shall be taken into account in applying subsection (a) to the taxpayer.

"(h) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

"(1) regulations to prevent the use of related parties, pass-thru entities, or intermediaries to avoid the application of this section, and

"(2) regulations providing for simplified procedures for the application of this section in the case of property described in subsection (b)(2)."

(b) Technical Amendments.—

(1) Section 189 is hereby repealed.

(2)(A) Section 280 is hereby repealed.

(B) Paragraph (5) of section 48(r) (defining sound recording) is amended to read as follows:

"(5) Sound recording.—For purposes of this subsection, the term 'sound recording' means works which result from the fixation of a series of musical, spoken, or other sounds, regardless of the nature of the material objects (such as discs, tapes, or other phonorecordings) in which such sounds are embodied."

(3) Section 312(n)(1) is amended—

(A) by striking out "(determined without regard to section 189) in subparagraph (B)", and

(B) by striking out subparagraph (C) and inserting in lieu thereof:

"(C) Construction period.—The term 'construction period' has the meaning given the term production period under section 263A(f)(4)(B)."

(4) Section 471 (relating to general rule for inventories) is amended—

(A) by striking out "Whenever" and inserting in lieu thereof "(a) General Rule.—Whenever", and

(B) by adding at the end thereof the following new subsection:

"(b) Cross Reference.—

"For rules relating to capitalization of direct and indirect costs of property, see section 263A."

(5) Section 267(e)(5)(D) is amended—

(A) by striking out "low-income housing (as defined in paragraph (5) of section 189(e))" and inserting "property described in clause (i), (ii), (iii), or (iv) of section 1250(a)(1)(B)", and

(B) by striking out "low-income housing (as so defined)" and inserting "such property".

(6) Section 278 is hereby repealed.

(7)(A) Subsection (b) of section 447 is amended to read as follows:

"(b) Preproductive Period of Expenses.—

"For rules requiring capitalization of certain preproductive period of expenses, see section 263A."

(B) Subsection (a) of section 447 is amended by striking out "and with the capitalization of preproductive period of expenses described in subsection (b)".

(C) Section 447(g)(1) (is amended by striking out "If" and inserting in lieu thereof "Notwithstanding subsection (a) or section 263A, if".

(8) Subsection (d) of section 464 is amended to read as follows:

"(d) Exception.—Subsection (a) shall not apply to any amount paid for supplies which are on hand at the close of the taxable year on account of fire, storm, or other casualty, or on account of disease or drought."

(c) Clerical Amendments.—

(1) The table of sections for part IX of subchapter B of chapter 1 is amended by striking out the item relating to section 278 and by inserting after the item relating to section 263 the following:

"Sec. 263A. Capitalization and inclusion in inventory costs of certain expenses."

(2) The table of sections for part VI of subchapter B of chapter 1 is amended by striking out the item relating to section 189.

(3) The table of sections for part IX of subchapter B of chapter 1 is amended by striking out the item relating to section 280.

(d) Effective Date.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to costs incurred after December 31, 1986, in taxable years ending after such date.

(2) Special rule for inventory property.—In the case of any property which is inventory in the hands of the taxpayer—

(A) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(B) Change in method of accounting.—If the taxpayer is required by the amendments made by this section to change its method of accounting with respect to such property for any taxable year—

(i) such change shall be treated as initiated by the taxpayer,

(ii) such change shall be treated as made with the consent of the Secretary, and

(iii) the period for taking into account the adjustments under section 481 by reason of such change shall not exceed 4 years.

(3) Special rule for self-constructed property.—The amendments made by this section shall not apply to any property which is produced by the taxpayer for use by the taxpayer if substantial construction had occurred before March 1, 1986.

(4) Transitional rule for capitalization of interest and taxes.—

(A) Transition property exempted from interest capitalization.—Section 263A(f) of the Internal Revenue Code of 1986 (as added by this section) and the amendment made by subsection (b)(1) shall not apply to any property—

(i) to which the amendments made by section 201 do not apply by reason of sections 203(a)(1)(D) and (E) and 203(a)(5)(A), and

(ii) to which the amendments made by section 251 do not apply by reason of section 251(d)(3)(M).

(B) Interest and taxes.—Section 263A of such Code shall not apply to property described in the matter following subparagraph (B) of section 207(e)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 to the extent it would require the capitalization of interest and taxes paid or incurred in connection with such property which are not required to be capitalized under section 189 of such Code (as in effect before the amendment made by subsection (b)(1)).

(5) Transition rule concerning capitalization of inventory rules.—In the case of a corporation which on the date of the enactment of this Act was a member of an affiliated group of corporations (within the meaning of section 1504(a) of the Internal Revenue Code of 1986), the parent of which—

(A) was incorporated in California on April 15, 1925,

(B) adopted LIFO accounting as of the close of the taxable year ended December 31, 1950, and

(C) was, on May 22, 1986, merged into a Delaware corporation incorporated on March 12, 1986,

the amendments made by this section shall apply under a cut-off method whereby the uniform capitalization rules are applied only in costing layers of inventory acquired during taxable years beginning on or after January 1, 1987.

(6) Treatment of certain rehabilitation project.—The amendments made by this section shall not apply to interest and taxes paid or incurred withrespect to the rehabilitation and conversion of a certified historic building which was formerly a factory into an apartment project with 155 units, 39 units of which are for low-income families, if the project was approved for annual interest assistance on June 10, 1986, by the housing authority of the State in which the project is located.

(7) Special rule for casualty losses.—Section 263A(d)(2) of the Internal Revenue Code of 1986 (as added by this section) shall apply to expenses incurred on or after the date of the enactment of this Act.

SEC. 804. MODIFICATIONS OF METHOD OF ACCOUNTING FOR LONG-TERM CONTRACT.

(a) General Rule.—Subpart B of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new section:

"SEC. 460. SPECIAL RULES FOR LONG-TERM CONTRACTS.

"(a) Percentage of Completion-Capitalized Cost Method.—

"(1) In general.—In the case of any long-term contract—

"(A) 40 percent of the items with respect to such contract shall be taken into account under the percentage of completion method (as modified by subsection (b)), and

"(B) 60 percent of the items with respect to such contract shall be taken into account under the taxpayer's normal method of accounting.

"(2) 40 percent look-back method to apply.—Upon completion of any long-term contract, the taxpayer shall pay (or shall be entitled to receive) interest determined by applying the look-back method of subsection (b)(3) to 40 percent of the items with respect to the contract.

"(b) Percentage of Completion Method.—

"(1) Subsection (a) Not to Apply Where Percentage of Completion Method Used.—Subsection (a) shall not apply to any long-term contract with respect to which amounts includible in gross income are determined under the percentage of completion method.

"(2) Requirements of percentage of completion method.—In the case of any long-term contract with respect to which the percentage of completion method is used—

"(A) the percentage of completion shall be determined by comparing costs allocated to the contract under subsection (c) and incurred before the close of the taxable year with the estimated total contract costs, and

"(B) upon completion of the contract, the taxpayer shall pay (or shall be entitled to receive) interest computed under the look-back method of paragraph (3).

"(3) LOOK-BACK METHOD.—The interest computed under the look-back method of this subparagraph shall be determined by—

"(A) first allocating income under the contract among taxable years before the year in which the contract is completed on the basis of the actual contract price and costs instead of the estimated contract price and costs,

"(B) second, determining (solely for purposes of computing such interest) the overpayment or underpayment of tax for each taxable year referred to in paragraph (1) which would result solely from the application of paragraph (1), and

"(C) then using the overpayment rate established by section 6621, compounded daily, on the overpayment or underpayment determined under paragraph (1).

"(c) ALLOCATION OF COSTS TO CONTRACT.—

"(1) DIRECT AND CERTAIN INDIRECT COSTS.—In the case of a long-term contract, all costs (including research and experimental costs) which directly benefit, or are incurred by reason of, the long-term contract activities of the taxpayer shall be allocated to such contract in the same manner as costs are allocated to extended period long-term contracts under section 451 and the regulations thereunder.

"(2) COSTS IDENTIFIED UNDER COST-PLUS AND CERTAIN FEDERAL CONTRACTS.—In the case of a cost-plus long-term contract or a Federal long-term contract, any cost not allocated to such contract under paragraph (1) shall be allocated to such contract if such cost is identified by the taxpayer (or a related person), pursuant to the contract or Federal, State, or local law or regulation, as being attributable to such contract.

"(3) ALLOCATION OF PRODUCTION PERIOD INTEREST TO CONTRACT.—

"(A) IN GENERAL.—Except as provided in subparagraphs (B) and (C), in the case of a long-term contract, interest costs shall be allocated to the contract in the same manner as interest costs are allocated to property produced by the taxpayer under section 263A(f).

"(B) PRODUCTION PERIOD.—In applying section 263A(f) for purposes of subparagraph (A), the production period shall be the period—

"(i) beginning on the later of—

"(I) the contract commencement date, or

"(II) in the case of a taxpayer who uses an accrual method with respect to long-term contracts, the date by which at least 5 percent of the total estimated costs (including design and planning costs) under the contract have been incurred, and

"(ii) ending on the contract completion date.

"(C) APPLICATION OF DE MINIMIS RULE.—In applying section 263A(f) for purposes of subparagraph (A), paragraph (1)(B)(iii) of such section shall be applied on a contract-by-

contract basis; except that, in the case of a taxpayer described in subparagraph (B)(i)(II) of this paragraph, paragraph (1)(B)(iii) of section 263A(f) shall be applied on a property-by-property basis.

"(4) CERTAIN COSTS NOT INCLUDED.—This subsection shall not apply to any—

"(A) independent research and development expenses,

"(B) expenses for unsuccessful bids and proposals, and

"(C) marketing, selling, and advertising expenses.

"(5) INDEPENDENT RESEARCH AND DEVELOPMENT EXPENSES.—For purposes of paragraph (4), the term 'independent research and development expenses' means any expenses incurred in the performance of research or development, except that such term shall not include—

"(A) any expenses which are directly attributable to a long-term contract in existence when such expenses are incurred, or

"(B) any expenses under an agreement to perform research or development.

"(d) FEDERAL LONG-TERM CONTRACT.—For purposes of this section—

"(1) IN GENERAL.—The term 'Federal long-term contract' means any long-term contract—

"(A) to which the United States (or any agency or instrumentality thereof) is a party, or

"(B) which is a subcontract under a contract described in subparagraph (A).

"(2) SPECIAL RULES FOR CERTAIN TAXABLE ENTITIES.—For purposes of paragraph (1), the rules of section 168(h)(2)(D) (relating to certain taxable entities not treated as instrumentalities) shall apply.

"(e) EXCEPTION FOR CERTAIN CONSTRUCTION CONTRACTS.—

"(1) IN GENERAL.—Subsections (a), (b), and (c)(1) and (2) shall not apply to any construction contract entered into by a taxpayer—

"(A) who estimates (at the time such contract is entered into) that such contract will be completed within the 2-year period beginning on the contract commencement date of such contract, and

"(B) whose average annual gross receipts for the 3 taxable years preceding the taxable year in which such contract is entered into do not exceed $10,000,000.

"(2) DETERMINATION OF TAXPAYER'S GROSS RECEIPTS.—For purposes of paragraph (1), the gross receipts of—

"(A) all trades or businesses (whether or not incorporated) which are under common control with the taxpayer (within the meaning of section 52(b)), and

"(B) all members of any controlled group of corporations of which the taxpayer is a member,

for the 3 taxable years of such persons preceding the taxable year in which the contract described in paragraph (1) is entered into shall be included in the gross receipts of the taxpayer for the period described in paragraph (1)(B). The Secretary shall prescribe regulations which provide attribution rules that take *into account, in addition to the persons and entities described in the preceding sentence, taxpayers who engage in construction contracts through partnerships, joint ventures, and corporations.*

"(3) CONTROLLED GROUP OF CORPORATIONS.—For purposes of this subsection, the term 'controlled group of corporations' has the meaning given to such term by section 1563(a), except that—

"(A) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1), and

"(B) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

"(4) CONSTRUCTION CONTRACT.—For purposes of this subsection, the term 'construction contract' means any contract for the building, construction, reconstruction, or rehabilitation of, or the installation of any integral component to, or improvements of, real property.

"(f) LONG-TERM CONTRACT.—For purposes of this section—

"(1) IN GENERAL.—The term 'long-term contract' means any contract for the manufacture, building, installation, or construction of property if such contract is not completed within the taxable year in which such contract is entered into.

"(2) SPECIAL RULE FOR MANUFACTURING CONTRACTS.—A contract for the manufacture of property shall not be treated as a long-term contract unless such contract involves the manufacture of—

"(A) any unique item of a type which is not normally included in the finished goods inventory of the taxpayer, or

"(B) any item which normally requires more than 12 calendar months to complete (without regard to the period of the contract).

"(3) AGGREGATION, ETC.—For purposes of this subsection, under regulations prescribed by the Secretary—

"(A) 2 or more contracts which are interdependent (by reason of pricing or otherwise) may be treated as 1 contract, and

"(B) a contract which is properly treated as an aggregation of separate contracts may be so treated.

"(g) CONTRACT COMMENCEMENT DATE.—For purposes of this section, the term 'contract commencement date' means, with respect to any contract, the first date on which any costs (other than bidding expenses or expenses incurred in connection with negotiating the contract) allocable to such contract are incurred."

(b) CHANGE IN REGULATIONS.—The Secretary of the Treasury or his delegate shall modify the income tax regulations relating to accounting for long-term contracts to carry out the provisions of section 460 of the Internal Revenue Code of 1986 (as added by subsection (a)).

(c) CONFORMING AMENDMENT.—The table of sections for subpart B of part II of subchapter E of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 460. Special rules for long-term contracts."

(d) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to any contract entered into after February 28, 1986.

(2) CLARIFICATION OF TREATMENT OF INDEPENDENT RESEARCH AND DEVELOPMENT EXPENSES.—

(A) IN GENERAL.—For periods before, on, or after the date of enactment of this Act—

(i) any independent research and development expenses taken into account in determining the total contract price shall not be severable from the contract, and

(ii) any independent research and development expenses shall not be treated as amounts chargeable to capital account.

(B) INDEPENDENT RESEARCH AND DEVELOPMENT EXPENSES.—For purposes of subparagraph (A), the term "independent research and development expenses" has the meaning given to such term by section 263A(c)(5) of the Internal Revenue Code of 1986, as added by this section.

SEC. 805. REPEAL OF RESERVE FOR BAD DEBTS OF TAXPAYERS OTHER THAN FINANCIAL INSTITUTIONS.

(a) GENERAL RULE.—Subsection (c) of section 166 (relating to reserve for bad debts) is hereby repealed.

(b) REPEAL OF RESERVE FOR CERTAIN GUARANTEED DEBT OBLIGATIONS.—Section 166 is amended by striking out subsection (f) and by redesignating subsection (g) as subsection (f).

(c) TECHNICAL AMENDMENTS.—

(1)(A) Section 81 (relating to certain increases in suspense accounts) is amended to read as follows:

"SEC. 81. INCREASE IN VACATION PAY SUSPENSE ACCOUNT.

"There shall be included in gross income for the taxable year the amount of any increase in any suspense account for such taxable year required by paragraph (2)(B) of section 463(c) (relating to accrual of vacation pay)."

(B) The table of sections for part II of subchapter B of chapter 1 is amended by striking out the item relating to section 81 and inserting in lieu thereof the following:

"Sec. 81. Increase in vacation pay suspense account."

(2) Clause (ii) of section 108(e)(7)(A) is amended by striking out "subsection (a), (b), or (c) of section 166" and inserting in lieu thereof "subsection (a) or (b) of section 166".

(3) Paragraph (7) of section 108(e) is amended by striking out subparagraph (B) and by redesignating subparagraphs (C), (D), (E), and (F) as subparagraphs (B), (C), (D), and (e), respectively.

(4) Subparagraph (E) of section 108(e)(7) (as so redesignated) is amended by striking out "subparagraphs (A), (B), (C), (D), and (E)" and inserting in lieu thereof "the foregoing subparagraphs".

(5) Paragraph (5) of section 461(h) is amended by striking out subparagraph (A) and by redesignating subparagraphs (B), (C), and (D) as subparagraphs (A), (B), and (C), respectively.

(6) Subsection (b) of section 805 is amended by striking out paragraph (2) and by redesignating paragraphs (3), (4), (5), and (6) as paragraphs (2), (3), (4), and (5), respectively.

(d) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Change in method of accounting.—In the case of any taxpayer who maintained a reserve for bad debts for such taxpayer's last taxable year beginning before January 1, 1987, and who is required by the amendments made by this section to change its method of accounting for any taxable year—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as made with the consent of the Secretary, and

(C) the net amount of adjustments required by section 481 of the Internal Revenue Code of 1986 to be taken into account by the taxpayer shall—

(i) in the case of a taxpayer maintaining a reserve under section 166(f), be reduced by the balance in the suspense account under section 166(f)(4) of such Code as of the close of such last taxable year, and

(ii) be taken into account ratably in each of the first 4 taxable years beginning after December 31, 1986.

SEC. 806. TAXABLE YEARS OF CERTAIN ENTITIES.

(a) Partnerships.—

(1) In general.—Paragraph (1) of section 706(b) (relating to partnership's taxable year) is amended to read as follows:

"(1) Partnership's taxable year.—

"(A) Partnership treated as taxpayer.—The taxable year of a partnership shall be determined as though the partnership were a taxpayer.

"(B) Taxable year determined by reference to partners.—Except as provided in subparagraph (C), a partnership shall not have a taxable year other than—

"(i) the taxable year of 1 or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent,

"(ii) if there is no taxable year described in clause (i), the taxable year of all the principal partners of the partnership, or

"(iii) if there is no taxable year described in clause (i) or (ii), the calendar year or such other period as the Secretary may prescribe in regulations.

"(C) Business purpose.—A partnership may have a taxable year not described in subparagraph (B) if it establishes, to the satisfaction of the Secretary, a business purpose therefor. For purposes of this subparagraph, any deferral of income to partners shall not be treated as a business purpose."

(2) Determination of majority interest.—Section 706(b) is amended by adding at the end thereof the following new paragraph:

"(4) Application of majority interest rule.—Clause (i) of paragraph (1)(B) shall not apply to any taxable year of a partnership unless the period which constitutes the taxable year of

1 or more of its partners who have an aggregate interest in partnership profits and capital of greater than 50 percent has been the same for—

"(A) the 3-taxable year period of such partner or partners ending on or before the beginning of such taxable year of the partnership, or

"(B) if the partnership has not been in existence during all of such 3-taxable year period, the taxable years of such partner or partners ending with or within the period of existence.

This paragraph shall apply without regard to whether the same partners or interests are taken into account in determining the 50 percent interest during any period."

(3) CONFORMING AMENDMENT.—The heading for section 706(b) is amended by striking out "ADOPTION OF".

(b) S CORPORATION.—

(1) IN GENERAL.—Section 1378(a) (relating to taxable year of S corporation) is amended to read as follows:

"(a) GENERAL RULE.—For purposes of this subtitle, the taxable year of an S corporation shall be a permitted year."

(2) BUSINESS PURPOSE.—Section 1378(b) (defining permitted year) is amended by adding at the end thereof the following new flush sentence:

"For purposes of paragraph (2), any deferral of income to shareholders shall not be treated as a business purpose."

(3) CONFORMING AMENDMENT.—Section 1378 is amended by striking out subsection (c).

(c) PERSONAL SERVICE CORPORATION.—

(1) IN GENERAL.—Section 441 (relating to period for computation of taxable income) is amended by adding at the end thereof the following new subsection:

"(i) TAXABLE YEAR OF PERSONAL SERVICE CORPORATIONS.—

"(1) IN GENERAL.—For purposes of this subtitle, the taxable year of any personal service corporation shall be the calendar year unless the corporation establishes, to the satisfaction of the Secretary, a business purpose for having a different period for its taxable year. For purposes of this paragraph, any deferral of income to shareholders shall not be treated as a business purpose.

"(2) PERSONAL SERVICE CORPORATION.—For purposes of this subsection, the term 'personal service corporation' has the meaning given such term by section 269A(b)(1), except that section 269A(b)(2) shall be applied—

"(A) by substituting 'any' for 'more than 10 percent', and

"(B) by substituting 'any' for '50 percent or more in value' in section 318(a)(2)(C)."

(2) CONFORMING AMENDMENT.—Section 267(a) (relating to matching of deduction and payee income in the case of expenses and interest) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, in the case of a personal service corporation (within the meaning of section 441(i)(2)), such corporation and any employee-owner (within the meaning of section 269A(b)(2), as modified by sec-

tion 441(i)(2)) shall be treated as persons specified in subsection (b).''

(d) COORDINATION WITH 52-53 WEEK PERIOD.—Section 441(f) (relating to election of year consisting of 52-53 weeks) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

''(3) SPECIAL RULE FOR PARTNERSHIPS, S CORPORATIONS, AND PERSONAL SERVICE CORPORATIONS.—The Secretary may by regulation provide terms and conditions for the application of this subsection to a partnership, S corporation, or personal service corporation (within the meaning of section 441(i)(2)).''

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) CHANGE IN ACCOUNTING PERIOD.—In the case of any taxpayer required by the amendments made by this section to change its accounting period for any taxable year—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as having been made with the consent of the Secretary, and

(C) with respect to any partner or shareholder of an S corporation which is required to include the items from more than 1 taxable year of the partnership or S corporation in any 1 taxable year, income in excess of expenses of such partnership or corporation for the short taxable year required by such amendments shall be taken into account ratably in each of the first 4 taxable years (including such short taxable year) beginning after December 31, 1986, unless such partner or shareholder elects to include all such income in the short taxable year.

Subparagraph (C) shall apply to a shareholder of an S corporation only if such corporation was an S corporation for a taxable year beginning in 1986.

Subtitle B—Treatment of Installment Obligations

SEC. 811. ALLOCATION OF INDEBTEDNESS AS PAYMENT ON INSTALLMENT OBLIGATION.

(a) IN GENERAL.—Subpart B of part II of subchapter E of chapter 1 (relating to taxable year for which item of gross income included) is amended by inserting after section 453B the following new section:

''SEC. 453C. CERTAIN INDEBTEDNESS TREATED AS PAYMENT ON INSTALLMENT OBLIGATIONS.

''(a) GENERAL RULE.—For purposes of sections 453 and 453A, if a taxpayer has allocable installment indebtedness for any taxable year, such indebtedness—

''(1) shall be allocated on a pro rata basis to any applicable installment obligation of the taxpayer which—

''(A) arises in such taxable year, and

"(B) is outstanding as of the close of such taxable year, and

"(2) shall be treated as a payment received on such obligation as of the close of such taxable year.

"(b) ALLOCABLE INSTALLMENT INDEBTEDNESS.—For purposes of this section—

"(1) IN GENERAL.—The term 'allocable installment indebtedness' means, with respect to any taxable year, the excess (if any) of—

"(A) the installment percentage of the taxpayer's average quarterly indebtedness for such taxable year, over

"(B) the aggregate amount treated as allocable installment indebtedness with respect to applicable installment obligations which—

"(i) are outstanding as of the close of such taxable year, but

"(ii) did not arise during such taxable year.

"(2) INSTALLMENT PERCENTAGE.—The term 'installment percentage' means the percentage (not in excess of 100 percent) determined by dividing—

"(A) the face amount of all applicable installment obligations of the taxpayer outstanding as of the close of the taxable year, by

"(B) the sum of—

"(i) the aggregate adjusted bases of all assets not described in clause (ii) held as of the close of the taxable year, and

"(ii) the face amount of all installment obligations outstanding as of such time.

For purposes of subparagraph (B)(i), a taxpayer may elect to compute the aggregate adjusted bases of all assets using the deduction for depreciation which is used in computing earnings and profits under section 312(k).

"(3) SPECIAL RULES FOR PERSONAL USE PROPERTY.—For purposes of this subsection—

"(A) for purposes of paragraph (2)(B), there shall not be taken into account any personal use property (within the meaning of section 1275(b)(3)) held by an individual or any installment obligation arising from the sale of such property, and

"(B) for purposes of computing the taxpayer's average quarterly indebtedness under paragraph (1)(A), there shall not be taken into account any indebtedness with respect to which substantially all of the property securing such indebtedness is property described in subparagraph (A).

"(4) SPECIAL RULE FOR CASUAL SALES.—If the taxpayer has no applicable installment obligations described in subclause (I) or (II) of subsection (e)(1)(A)(i) outstanding at any time during the taxable year, then the taxpayer's allocable installment indebtedness for such taxable year shall be computed by using the taxpayer's indebtedness as of the close of such taxable year in lieu of the taxpayer's average quarterly indebtedness.

"(c) TREATMENT OF SUBSEQUENT PAYMENTS.—

"(1) Payments treated as receipt of tax paid amounts.—If any amount is treated as received under subsection (a) (after application of subsection (d)(2)) with respect to any applicable installment obligation, subsequent payments received on such obligation shall not be taken into account for purposes of sections 453 and 453A to the extent that the aggregate amount of such subsequent payments does not exceed the aggregate amount treated as received on such obligation under subsection (a).

"(2) Reduction of allocable installment indebtedness.—For purposes of applying subsection (b)(1)(B) for the taxable year in which any payment to which paragraph (1) of this subsection applies was received (and for any subsequent taxable year), the allocable installment indebtedness with respect to the applicable installment obligation shall be reduced (but not below zero) by the amount of such payment not taken into account by reason of paragraph (1).

"(d) Limitation Based on Total Contract Price.—

"(1) In general.—The amount treated as received under subsection (a) (after application of paragraph (2)) with respect to any applicable installment obligation for any taxable year shall not exceed the excess (if any) of—

"(A) the total contract price, over

"(B) any portion of the total contract price received under the contract before the close of such taxable year—

"(i) including amounts so treated under subsection (a) for all preceding taxable years (after application of paragraph (2)), but

"(ii) not including amounts not taken into account by reason of subsection (c).

"(2) Excess allocable installment indebtedness.—If, after application of paragraph (1), the allocable installment indebtedness for any taxable year exceeds the amount which may be allocated to applicable installment obligations arising in (and outstanding as of the close of) such taxable year, such excess shall—

"(A) subject to the limitations of paragraph (1), be allocated to applicable installment obligations outstanding as of the close of such taxable year which arose in preceding taxable years, beginning with applicable installment obligations arising in the earliest preceding taxable year, and

"(B) be treated as a payment under subsection (a)(2).

"(e) Definitions and Special Rules.—For purposes of this section—

"(1) Applicable installment obligation.—

"(A) In general.—The term 'applicable installment obligation' means any obligation—

"(i) which arises from the disposition—

"(I) after February 28, 1986, of personal property under the installment method by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan,

"(II) after February 28, 1986, of real property under the installment method which is held by the

taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business, or

"(III) after August 16, 1986, of real property under the installment method which is property used in the taxpayer's trade or business or property held for the production of rental income, but only if the sales price of such property exceeds $150,000 (determined after application of the rule under the last sentence of section 1274(c)(3)(A)(ii)), and

"(ii) which is held by the seller or a member of the same affiliated group (within the meaning of section 1504(a), but without regard to section 1504(b)) as the seller.

"(B) Exception for personal use and farm property.—The term 'applicable installment obligation' shall not include any obligation which arises from the disposition—

"(i) by an individual of personal use property (within the meaning of section 1275(b)(3)), or

"(ii) of any property used or produced in the trade or business of farming (within the meaning of section 2032A(e) (4) or (5)).

"(2) Aggregation rules.—For purposes of this section, all persons treated as a single employer under section 52 shall be treated as 1 taxpayer. The Secretary shall prescribe regulations for the treatment under this section of transactions between such persons.

"(3) Aggregation of obligations.—The Secretary may by regulations provide that all (or any portion of) applicable installment obligations of a taxpayer may be treated as 1 obligation.

"(4) Exception for sales of timeshares and residential lots.—

"(A) In general.—If a taxpayer elects the application of this paragraph, this section shall not apply to any installment obligation which—

"(i) arises from a sale in the ordinary course of the taxpayer's trade or business to an individual of—

"(I) a timeshare right to use or a timeshare ownership interest in residential real property for not more than 6 weeks, or a right to use specified campgrounds for recreational purposes, or

"(II) any residential lot but only if the taxpayer (or any related person) is not to make any improvements with respect to such lot, and

"(ii) which is not guaranteed by any person other than an individual.

For purposes of clause (i)(I), a timeshare right to use (or timeshare ownership interest in) property held by the spouse, children, grandchildren, or parents of an individual shall be treated as held by such individual.

"(B) Interest on deferred tax.—If subparagraph (A) applies to any installment obligation, interest shall be paid on the portion of any tax for any taxable year (determined without regard to any deduction allowable for such inter-

est) which is attributable to the receipt of payments on such obligation in such year (other than payments received in the taxable year of the sale). Such interest shall be computed for the period from the date of the sale to the date on which the payment is received using the applicable Federal rate under section 1274 (without regard to subsection (d)(2) or (3) thereof) in effect at the time of the sale, compounded semiannually.

"(C) TIME FOR PAYMENT.—Any interest payable under this paragraph with respect to a payment shall be treated as an addition to tax for the taxable year in which the payment is received, except that the amount of such interest shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.

"(5) REGULATIONS.—The Secretary shall prescribe regulations as may be necessary to carry out the purposes of this section, including regulations—

"(A) disallowing the use of the installment method in whole or in part for transactions in which the rules of this section otherwise would be avoided through the use of related parties, pass-through entities, or intermediaries,

"(B) providing for the proper treatment of reserves (including consistent treatment with assets held in the reserves), and

"(C) providing that subsection (b)(4) shall not apply where necessary to prevent the avoidance of the application of this section."

(b) CLERICAL AMENDMENT.—The table of sections for subpart B of part II of subchapter E of chapter 1 is amended by inserting after the item relating to section 453B the following new item:

"Sec. 453C. Certain indebtedness treated as payments on installment obligations."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this section, the amendments made by this section shall apply to taxable years ending after December 31, 1986, with respect to dispositions after February 28, 1986.

(2) EXCEPTION FOR CERTAIN SALES OF PROPERTY BY A MANUFACTURER TO A DEALER.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any installment obligation arising from the disposition of tangible personal property by a manufacturer (or any affiliate) to a dealer if—

(i) the dealer is obligated to pay on such obligation only when the dealer resells (or rents) the property,

(ii) the manufacturer has the right to repurchase the property at a fixed (or ascertainable) price after no later than the 9-month period beginning with the date of the sale, and

(iii) such disposition is in a taxable year with respect to which the requirements of subparagraph (B) are met.

(B) RECEIVABLES MUST BE AT LEAST 50 PERCENT OF TOTAL SALES.—

(i) IN GENERAL.—The requirements of this subparagraph are met with respect to any taxable year if for such taxable year and the preceding taxable year the aggregate face amount of installment obligations described in subparagraph (A) is at least 50 percent of the total sales to dealers giving rise to such obligations.

(ii) TAXPAYER MUST FAIL FOR 2 CONSECUTIVE YEARS.—A taxpayer shall be treated as failing to meet the requirements of clause (i) only if the taxpayer fails to meet the 50-percent test for both the taxable year and the preceding taxable year.

(C) TRANSITION RULE.—An obligation issued before the date of the enactment of this Act shall be treated as described in subparagraph (A) if, within 60 days after such date, the taxpayer modifies the terms of such obligation to conform to the requirements of subparagraph (A).

(D) APPLICATION WITH OTHER OBLIGATIONS.—In applying section 453C of the Internal Revenue Code of 1986 to any installment obligations to which the amendments made by this section apply, obligations described in subparagraph (A) shall not be treated as applicable installment obligations (within the meaning of section 453C(e)(1) of such Code).

(E) OTHER REQUIREMENTS.—This paragraph shall apply only if the taxpayer meets the requirements of subparagraphs (A) and (B) for its first taxable year beginning after the date of the enactment of this Act.

(3) EXCEPTION FOR CERTAIN OBLIGATIONS.—In applying the amendments made by this section to any installment obligation of a corporation incorporated on January 13, 1928, the following indebtedness shall not be taken into account in determining the allocable installment indebtedness of such corporation under section 453C of the Internal Revenue Code of 1986 (as added by this section):

(A) 12⅝ percent subordinated debentures with a total face amount of $175,000,000 issued pursuant to a trust indenture dated as of September 1, 1985.

(B) A revolving credit term loan in the maximum amount of $130,000,000 made pursuant to a revolving credit and security agreement dated as of September 6, 1985, payable in various stages with final payment due on August 31, 1992.

This paragraph shall also apply to indebtedness which replaces indebtedness described in this paragraph if such indebtedness does not exceed the amount and maturity of the indebtedness it replaces.

(4) SPECIAL RULE FOR RESIDENTIAL CONDOMINIUM PROJECT.—For purposes of applying the amendments made by this section, the term applicable installment obligation (within the meaning of section 453C(e)(1) of the Internal Revenue Code of 1986) shall not include any obligation arising in connection with sales from a residential condominium project—

(A) for which a contract to purchase land for the project was entered into at least 5 years before the date of the enactment of this Act,

(B) with respect to which land for the project was purchased before September 26, 1985,

(C) with respect to which building permits for the project were obtained, and construction commenced, before September 26, 1985,

(D) in conjunction with which not less than 80 units of low-income housing are deeded to a tax-exempt organization designated by a local government, and

(E) with respect to which at least $1,000,000 of expenses were incurred before September 26, 1985.

(D) the portion of the net adjustment taken into account in the 1st taxable year of the taxpayer ending after December 31, 1986, shall not exceed 15 percent of such adjustment, and

(E) the remaining portion of such adjustment shall be taken into account ratably in the 2nd, 3rd, and 4th years ending after December 31, 1986.

(5) SPECIAL RULE FOR QUALIFIED BUYOUT.—The amendments made by this section shall apply for taxable years ending after December 31, 1991, to a corporation if—

(A) such corporation was incorporated on May 25, 1984, for the purpose of acquiring all of the stock of another corporation,

(B) such acquisition took place on October 23, 1985,

(C) in connection with such acquisition, the corporation incurred indebtedness of approximately $151,000,000, and

(D) substantially all of the stock of the corporation is owned directly or indirectly by employees of the corporation the stock of which was acquired on October 23, 1985.

(6) SPECIAL RULE FOR SALES OF REAL PROPERTY BY DEALERS.—In the case of installment obligations arising from the sale of real property in the ordinary course of the trade or business of the taxpayer, any gain attributable to allocable installment indebtedness allocated to any such installment obligations which arise (or are deemed to arise)—

(A) in the 1st taxable year of the taxpayer ending after December 31, 1986, shall be taken into account ratably over the 3 taxable years beginning with such 1st taxable year, and

(B) in the 2nd taxable year of the taxpayer ending after December 31, 1986, shall be taken into account ratably over the 2 taxable years beginning with such 2nd taxable year.

(7) SPECIAL RULE FOR SALES OF PERSONAL PROPERTY BY DEALERS.—In the case of installment obligations arising from the sale of personal property in the ordinary course of the trade or business of the taxpayer, solely for purposes of determining the time for payment of tax and interest payable with respect to such tax—

(A) any increase in tax imposed by chapter 1 of the Internal Revenue Code of 1986 for the 1st taxable year of the taxpayer ending after December 31, 1986, by reason of the

amendments made by this section shall be treated as imposed ratably over the 3 taxable years beginning with such 1st taxable year, and

(B) any increase in tax imposed by such chapter 1 for the 2nd taxable year of the taxpayer ending after December 31, 1986, (determined without regard to subparagraph (A)) by reason of the amendments made by this section shall be treated as imposed ratably over the 2 taxable years beginning with such 2d taxable year.

(8) TREATMENT OF CERTAIN INSTALLMENT OBLIGATIONS.—Notwithstanding the amendments made by subtitle B of title III, gain with respect to installment payments received pursuant to notes issued in accordance with a note agreement dated as of August 29, 1980, where—

(A) such note agreement was executed pursuant to an agreement of purchase and sale dated April 25, 1980,

(B) more than ½ of the installment payments of the aggregate principal of such notes have been received by August 29, 1986, and

(C) the last installment payment of the principal of such notes is due August 29, 1989,

shall be taxed at a rate of 28 percent.

SEC. 812. DISALLOWANCE OF USE OF INSTALLMENT METHOD FOR CERTAIN OBLIGATIONS.

(a) IN GENERAL.—Section 453 (relating to installment method) is amended by adding at the end thereof the following new subsection:

"(j) CURRENT INCLUSION IN CASE OF REVOLVING CREDIT PLANS, ETC.—In the case of—

"(1) any disposition of personal property under a revolving credit plan, or

"(2) any installment obligation arising out of a sale of—

"(A) stock or securities which are traded on an established securities market, or

"(B) to the extent provided in regulations, property (other than stock or securities) of a kind regularly traded on an established market,

subsection (a) and section 453A shall not apply, and, for purposes of this title, all payments to be received shall be treated as received in the year of disposition. The Secretary may provide for the application of this subsection in whole or in part for transactions in which the rules of this subsection otherwise would be avoided through the use of related parties, pass-thru entities, or intermediaries."

(b) CONFORMING AMENDMENTS.—

(1) Section 453A(a)(2) (relating to installment method for dealers in personal property) is amended by striking out the last sentence thereof.

(2) Section 453A is amended by adding at the end thereof the following new subsection:

"(c) CROSS REFERENCE.—

"For disallowance of use of installment method for certain obligations, see section 453(j)."

(c) EFFECTIVE DATE.—

(1) In general.—Except as provided in paragraph (2), the amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

(2) Change in method of accounting.—In the case of any taxpayer who made sales under a revolving credit plan and was on the installment method under section 453 or 453A of the Internal Revenue Code of 1986 for such taxpayer's last taxable year beginning before January 1, 1987, the amendments made by this section shall be treated as a change in method of accounting for its 1st taxable year beginning after December 31, 1986, and—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as having been made with the consent of the Secretary, and

(C) the period for taking into account adjustments under section 481 of such Code by reason of such change shall not exceed 4 years.

Subtitle C—Other Provisions

SEC. 821. INCOME ATTRIBUTABLE TO UTILITY SERVICES.

(a) In General.—Section 451 (relating to general rule for taxable year of inclusion) is amended by adding at the end thereof the following new subsection:

"(f) Special Rule for Utility Services.—

"(1) In general.—In the case of a taxpayer the taxable income of which is computed under an accrual method of accounting, any income attributable to the sale or furnishing of utility services to customers shall be included in gross income not later than the taxable year in which such services are provided to such customers.

"(2) Definition and special rule.—For purposes of this subsection—

"(A) Utility services.—The term 'utility services' includes—

"(i) the providing of electrical energy, water, or sewage disposal,

"(ii) the furnishing of gas or steam through a local distribution system,

"(iii) telephone or other communication services, and

"(iv) the transporting of gas or steam by pipeline.

"(B) Year in which services provided.—The taxable year in which services are treated as provided to customers shall not, in any manner, be determined by reference to—

"(i) the period in which the customers' meters are read, or

"(ii) the period in which the taxpayer bills (or may bill) the customers for such service."

(b) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) CHANGE IN METHOD OF ACCOUNTING.—If a taxpayer is required by the amendments made by this section to change its method of accounting for any taxable year—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as having been made with the consent of the Secretary, and

(C) the adjustments under section 481 of the Internal Revenue Code of 1954 by reason of such change shall be taken into account ratably over a period no longer than the first 4 taxable years beginning after December 31, 1986.

(3) SPECIAL RULE FOR CERTAIN CYCLE BILLING.—If a taxpayer for any taxable year beginning before August 16, 1986, for purposes of chapter 1 of the Internal Revenue Code of 1986 took into account income from services described in section 451(f) of such Code (as added by subsection (a)) on the basis of the period in which the customers' meters were read, then such treatment for such year shall be deemed to be proper.

SEC. 822. REPEAL OF APPLICATION OF DISCHARGE OF INDEBTEDNESS RULES TO QUALIFIED BUSINESS INDEBTEDNESS.

(a) GENERAL RULE.—Paragraph (1) of section 108(a) (relating to exclusion from gross income of income from discharge of indebtedness) is amended by striking out subparagraph (C), by inserting "or" at the end of subparagraph (A), and by striking out ", or" at the end of subparagraph (B) and inserting in lieu thereof a period.

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 108(a) is amended to read as follows:

"(2) COORDINATION OF EXCLUSIONS.—Subparagraph (B) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case."

(2) Section 108 is amended by striking out subsection (c).

(3) Section 108(d) is amended—

(A) by striking out paragraph (4),

(B) by striking out "subsections (a), (b), and (c)" each place it appears in the heading thereof and in the text and heading of paragraphs (6) and (7) and inserting in lieu thereof "subsections (a) and (b)",

(C) by striking out the last sentence of paragraph (7)(B), and

(D) by striking out "under paragraph (4) of this subsection or" in paragraph (9) thereof.

(4) Section 1017(a)(2) is amended by striking out ", (b)(5), or (c)(1)(A)" and inserting in lieu thereof "or (b)(5)".

(5) Section 1017(b)(3)(A) is amended by striking out "or (c)(1)(A)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to discharges after December 31, 1986.

SEC. 823. REPEAL OF DEDUCTION FOR QUALIFIED DISCOUNT COUPONS.

(a) GENERAL RULE.—Section 466 (relating to qualified discount coupons redeemed after close of taxable year) is repealed.

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (5) of section 461(h) is amended by striking out subparagraph (C) and by redesignating subparagraph (D) as subparagraph (C).

(2) The table of contents for subpart C of part II of subchapter E of chapter 1 is amended by striking out the item relating to section 466.

(c) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Change in method of accounting.—In the case of any taxpayer who elected to have section 466 of the Internal Revenue Code of 1954 apply for such taxpayer's last taxable year beginning before January 1, 1987, and is required to change its method of accounting by reason of the amendments made by this section for any taxable year—

(A) such change shall be treated as initiated by the taxpayer,

(B) such change shall be treated as having been made with the consent of the Secretary, and

(C) the net amount of adjustments required by section 481 of the Internal Revenue Code of 1986 to be taken into account by the taxpayer shall—

(i) be reduced by the balance in the suspense account under section 466(e) of such Code as of the close of such last taxable year, and

(ii) be taken into account over a period not longer than 4 years.

SEC. 824. INCLUSION IN GROSS INCOME OF CONTRIBUTIONS IN AID OF CONSTRUCTION.

(a) General Rule.—Section 118 (relating to contributions to the capital of a corporation) is amended by striking out subsections (b) and (c), by redesignating subsection (d) as subsection (c), and by inserting after subsection (a) the following new subsection:

"(b) Contributions in Aid of Construction, Etc.—For purposes of subsection (a), the term 'contribution to the capital of the taxpayer' does not include any contribution in aid of construction or any other contribution as a customer or potential customer."

(b) Technical Amendment.—Subsection (c) of section 362 (relating to special rules for certain contributions to capital) is amended by striking out paragraph (3).

(c) Effective Date.—

(1) In general.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to amounts received after December 31, 1986, in taxable years ending after such date.

(2) Treatment of certain water supply projects.—The amendments made by this section shall not apply to amounts which are paid by the New Jersey Department of Environmental Protection for construction of alternative water supply projects in zones of drinking water contamination and which are designated by such department as being taken into account under this paragraph. Not more than $4,631,000 of such amounts may be designated under the preceding sentence.

(3) Treatment of certain contributions by transportation authority.—The amendments made by this section shall not apply to contributions in aid of construction by a qualified transportation authority which were clearly identified in a master plan in existence on September 13, 1984, and which are designated by such authority as being taken into account under this paragraph. Not more than $68,000,000 of such contributions may be designated under the preceding sentence. For purposes of this paragraph, a qualified transportation authority is an entity which was created on February 20, 1967, and which was established by an interstate compact and consented to by Congress in Public Law 89–774, 80 Stat. 1324 (1966).

(4) Treatment of certain partnerships.—In the case of a partnership with a taxable year beginning May 1, 1986, if such partnership realized net capital gain during the period beginning on the 1st day of such taxable year and ending on May 29, 1986, pursuant to an indemnity agreement dated May 6, 1986, then such partnership may elect to treat each asset to which such net capital gain relates as having been distributed to the partners of such partnership in proportion to their distributive share of the capital gain or loss realized by the partnership with respect to such asset and to treat each such asset as having been sold by each partner on the date of the sale of the asset by the partnership. If such an election is made, the consideration received by the partnership in connection with the sale of such assets shall be treated as having been received by the partners in connection with the deemed sale of such assets. In the case of a tiered partnership, for purposes of this paragraph each partnership shall be treated as having realized net capital gain equal to its proportionate share of the net capital gain of each partnership in which it is a partner, and the election provided by this paragraph shall apply to each tier.

TITLE IX—FINANCIAL INSTITUTIONS

SEC. 901. LIMITATIONS ON BAD DEBT RESERVES.

(a) Large Banks Not Eligible for Bad Debt Reserves.—

(1) In general.—Subsection (a) of section 585 (relating to reserves for losses on loans of banks) is amended to read as follows:

"(a) Reserve for Bad Debts.—

"(1) In general.—Except as provided in subsection (c), a bank shall be allowed a deduction for a reasonable addition to a reserve for bad debts. Such deduction shall be in lieu of any deduction under section 166(a).

"(2) Bank.—For purposes of this section—

"(A) In general.—The term 'bank' means any bank (as defined in section 581) other than an organization to which section 593 applies.

"(B) Banking business of United States branch of foreign corporation.—The term 'bank' also includes any corporation to which subparagraph (A) would apply except for the fact that it is a foreign corporation. In the case of

any such foreign corporation, this section shall apply only with respect to loans outstanding the interest on which is effectively connected with the conduct of a banking business within the United States."

(2) Reserve deduction not available for large banks.—Section 585 is amended by adding at the end thereof the following new subsection:

"(c) Section Not To Apply to Large Banks.—

"(1) In general.—In the case of a large bank, this section shall not apply (and no deduction shall be allowed under any other provision of this subtitle for any addition to a reserve for bad debts).

"(2) Large banks.—For purposes of this subsection, a bank is a large bank if, for the taxable year (or for any preceding taxable year beginning after December 31, 1986)—

"(A) the average adjusted bases of all assets of such bank exceeded $500,000,000, or

"(B) such bank was a member of a parent-subsidiary controlled group and the average adjusted bases of all assets of such group exceeded $500,000,000.

"(3) 4-year spread of adjustments.—

"(A) In general.—Except as provided in paragraph (4), in the case of any bank which for its last taxable year before the disqualification year maintained a reserve for bad debts—

"(i) the provisions of this subsection shall be treated as a change in the method of accounting of such bank for the disqualification year,

"(ii) such change shall be treated as having been made with the consent of the Secretary, and

"(iii) the net amount of adjustments required by section 481(a) to be taken into account by the taxpayer shall be taken into account in each of the 4 taxable years beginning with the disqualification year with—

"(I) the amount taken into account for the 1st of such taxable years being the greater of 10 percent of such net amount or such greater amount as the taxpayer may designate, and

"(II) the amount taken into account in each of the 3 succeeding taxable years being equal to the applicable fraction (determined in accordance with the following table for the taxable year involved) of the portion of such net amount not taken into account under subclause (I).

If the case of the—	*The applicable fraction is—*
1st succeeding year	*2/9*
2nd succeeding year	*1/3*
3rd succeeding year	*4/9.*

"(B) Suspension of recapture for taxable year for which bank is financially troubled.—

"(i) In general.—In the case of a bank which is a financially troubled bank for any taxable year—

"(I) no adjustment shall be taken into account under subparagraph (A) for such taxable year, and

"(II) such taxable year shall be disregarded in determining whether any other taxable year is a taxable year for which an adjustment is required to be taken into account under subparagraph (A) or the amount of such adjustment.

"(ii) EXCEPTION FOR ELECTIVE RECAPTURE FOR 1ST YEAR.—Clause (i) shall not apply to the 1st taxable year referred to in subparagraph (A)(iii)(I) if the taxpayer designates an amount in accordance with such subparagraph.

"(iii) FINANCIALLY TROUBLED BANK.—For purposes of clause (i), the term 'financially troubled bank' means any bank if, for the taxable year, the nonperforming loan percentage of such bank exceeds 75 percent.

"(iv) NONPERFORMING LOAN PERCENTAGE.—For purposes of clause (iii), the term 'nonperforming loan percentage' means the percentage determined by dividing—

"(I) the sum of the outstanding balances of nonperforming loans of the bank as of the close of each quarter of the taxable year, by

"(II) the sum of the amounts of equity of the bank as of the close of each such quarter.

In the case of a bank which is a member of a parent-subsidiary controlled group for the taxable year, the preceding sentence shall be applied with respect to such group.

"(v) OTHER DEFINITIONS.—For purposes of this subparagraph—

"(I) NONPERFORMING LOANS.—The term 'nonperforming loan' means any loan which is considered to be nonperforming by the primary Federal regulatory agency with respect to the bank.

"(II) EQUITY.—The term 'equity' means the equity of the bank as determined for Federal regulatory purposes.

"(C) COORDINATION WITH ESTIMATED TAX PAYMENTS.—For purposes of applying section 6655(d)(3) with respect to any installment, the determination under subparagraph (B) of whether an adjustment is required to be taken into account under subparagraph (A) shall be made as of the last day prescribed for payment of such installment.

"(4) ELECTIVE CUT-OFF METHOD.—If a bank makes an election under this paragraph for the disqualification year—

"(A) the provisions of this subsection shall not be treated as a change in the method of accounting of the taxpayer for purposes of section 481,

"(B) the taxpayer shall continue to maintain its reserve for loans held by the bank as of the 1st day of the disqualification year and charge against such reserve any losses resulting from loans held by the bank as of such 1st day, and

"(C) no deduction shall be allowed under this section (or any other provision of this subtitle) for any addition to such reserve for the disqualification year or any subsequent taxable year.

"(5) DEFINITIONS.—For purposes of this subsection—

"(A) PARENT-SUBSIDIARY CONTROLLED GROUP.—The term 'parent-subsidiary controlled group' means any controlled group of corporations described in section 1563(a)(1). In determining the average adjusted bases of assets held by such a group, interests held by one member of such group in another member of such group shall be disregarded.

"(B) DISQUALIFICATION YEAR.—The term 'disqualification year' means, with respect to any bank, the 1st taxable year beginning after December 31, 1986, for which such bank was a large bank if such bank maintained a reserve for bad debts for the preceding taxable year."

(b) RESERVES OF DOMESTIC BUILDING AND LOAN ASSOCIATIONS, MUTUAL SAVINGS BANKS, AND COOPERATIVE BANKS.—

(1) IN GENERAL.—Subsection (a) of section 593 (relating to reserves for losses on loans) is amended to read as follows:

"(a) RESERVE FOR BAD DEBTS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), in the case of—

"(A) any domestic building and loan association,

"(B) any mutual savings bank, or

"(C) any cooperative bank without capital stock organized and operated for mutual purposes and without profit,

there shall be allowed a deduction for a reasonable addition to a reserve for bad debts. Such deduction shall be in lieu of any deduction under section 166(a).

"(2) ORGANIZATION MUST MEET 60-PERCENT ASSET TEST OF SECTION 7701(a)(19).—This section shall apply to an association or bank referred to in paragraph (1) only if it meets the requirements of section 7701(a)(19)(C)."

(2) LIMITATION ON PERCENTAGE OF TAXABLE INCOME METHOD.—Paragraph (2) of section 593(b) (relating to percentage of taxable income method) is amended—

(A) by striking out subparagraphs (A), (B), and (C) and inserting in lieu thereof the following:

"(A) IN GENERAL.—Subject to subparagraphs (B) and (C), the amount determined under this paragraph for the taxable year shall be an amount equal to 8 percent of the taxable income for such year.

"(B) REDUCTION FOR AMOUNTS REFERRED TO IN PARAGRAPH (1)(A).—The amount determined under subparagraph (A) shall be reduced (but not below 0) by the amount determined under paragraph (1)(A).", and

(B) by redesignating subparagraphs (D) and (E) as subparagraphs (C) and (D), respectively.

(3) REPEAL OF PERCENTAGE METHOD OF COMPUTING RESERVES FOR BAD DEBTS.—Subsection (b) of section 593 (relating to addition to reserves for bad debts) is amended by striking out paragraphs (3) and (5) and by redesignating paragraph (4) as paragraph (3).

(4) Section 593 reserves not treated as preference for purposes of section 291.—Subparagraph (A) of section 291(e)(1) (defining financial institution preference item) is amended by striking out "or 593".

(c) Repeal of Section 586.—Section 586 (relating to reserves for losses on loans of small business investment companies, etc.) is hereby repealed.

(d) Conforming Amendments.—

(1) Amendment to section 585.—Paragraph (1) of section 585(b) is amended by striking out "section 166(c)" and inserting in lieu thereof "subsection (a)".

(2) Amendments to section 593.—

(A) Paragraph (1) of section 593(b) is amended by striking out "section 166(c)" and inserting in lieu thereof "subsection (a)".

(B) Subparagraph (B) of section 593(b)(1) is amended—

(i) by striking out "paragraph (2), (3), or (4), whichever amount is the largest" and inserting in lieu thereof "paragraph (2) or (3), whichever is the larger", and

(ii) by striking out "paragraph (4)" in clause (i) and inserting in lieu thereof "paragraph (3)".

(B) Subparagraph (D) of section 593(b)(2) (as redesignated by subsection (b)(2)) is amended by striking out "the applicable percentage (determined under subparagraphs (A) and (B))" and inserting in lieu thereof "8 percent"

(C) Subparagraph (B) of section 593(e)(1) is amended by striking out "subsection (b)(4)" and inserting in lieu thereof "subsection (b)(3)".

(3) Bonds, etc., losses and gains of financial institutions.—

(A) Paragraph (1) of section 582(c) (relating to bonds, etc., losses and gains of financial institutions) is amended by striking out "a financial institution to which section 585, 586, or 593 applies" and inserting in lieu thereof "a financial institution referred to in paragraph (5)".

(B) Subsection (c) of section 582 is amended by adding at the end thereof the following new paragraph:

"(5) Financial institutions to which paragraph (1) applies.—

"(A) In general.—For purposes of paragraph (1), the financial institutions referred to in this paragraph are—

"(i) any bank (and any corporation which would be a bank except for the fact it is a foreign corporation),

"(ii) any financial institution referred to in section 591,

"(iii) any small business investment company operating under the Small Business Investment Act of 1958, and

"(iv) any business development corporation.

"(B) Business development corporation.—For purposes of subparagraph (A), the term 'business development corporation' means a corporation which was created by or pursuant to an act of a State legislature for purposes of promoting, maintaining, and assisting the economy and indus-

try within such State on a regional or statewide basis by making loans to be used in trades and businesses which would generally not be made by banks within such region or State in the ordinary course of their business (except on the basis of a partial participation), and which is operated primarily for such purposes.

"(C) LIMITATIONS ON FOREIGN BANKS.—In the case of a foreign corporation referred to in subparagraph (A)(i), paragraph (1) shall only apply to gains and losses which are effectively connected with the conduct of a banking business in the United States."

(4) OTHER CONFORMING AMENDMENTS.—

(A) Subsection (g) of section 166 is amended by striking out paragraphs (3) and (4).

(B) Subparagraph (F) of section 172(b)(1) is amended by striking out "to which section 585, 586, or 593 applies" and inserting in lieu thereof "referred to in section 582(c)(5)".

(C) Clause (i) of section 291(e)(1)(B) is amended by striking out "to which section 585 or 593 applies" and inserting in lieu thereof "which is a bank (as defined in section 582(a)(2)) or to which section 593 applies".

(D) Section 596 is amended by striking out "an amount equal to" and all that follows down through the period at the end thereof and inserting in lieu thereof "an amount equal to 8 percent of such total amount.".

(E) Paragraph (4) of section 856(a) is amended by striking out "to which section 585, 586, or 593 applies" and inserting in lieu thereof "referred to in section 582(c)(5)".

(F) Subsection (c) of section 1277 is amended by striking out "to which section 585 or 593 applies" and inserting in lieu thereof "which is a bank (as defined in section 585(a)(2) or to which section 593 applies".

(G) Subparagraph (B) of section 1361(b)(2) is amended by striking out "to which section 585 or 593 applies" and inserting in lieu thereof "which is a bank (as defined in section 585(a)(2)) or to which section 593 applies".

(H) The table of sections for part I of subchapter H of chapter 1 is amended by striking out the item relating to section 586.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 902. INTEREST INCURRED TO CARRY TAX-EXEMPT BONDS.

(a) GENERAL RULE.—Section 265 (relating to expenses and interest relating to tax-exempt income) is amended by adding at the end thereof the following new subsection:

"(b) PRO RATA ALLOCATION OF INTEREST EXPENSE OF FINANCIAL INSTITUTIONS TO TAX-EXEMPT INTEREST.—

"(1) IN GENERAL.—In the case of a financial institution, no deduction shall be allowed for that portion of the taxpayer's interest expense which is allocable to tax-exempt interest.

"(2) ALLOCATION.—For purposes of paragraph (1), the portion of the taxpayer's interest expense which is allocable to tax-

exempt interest is an amount which bears the same ratio to such interest expense as—

"(A) the taxpayer's average adjusted bases (within the meaning of section 1016) of tax-exempt obligations acquired after August 7, 1986, bears to

"(B) such average adjusted bases for all assets of the taxpayer.

"(3) EXCEPTION FOR CERTAIN TAX-EXEMPT OBLIGATIONS.—

"(A) IN GENERAL.—Any qualified tax-exempt obligation acquired after August 7, 1986, shall be treated for purposes of paragraph (2) and section 291(e)(1)(B) as if it were acquired on August 7, 1986.

"(B) QUALIFIED TAX-EXEMPT OBLIGATION.—For purposes of subparagraph (A), the term 'qualified tax-exempt obligation' means a tax-exempt obligation which—

"(i) is not a private activity bond (as defined in section 141), and

"(ii) is designated by the issuer for purposes of this paragraph.

For purposes of the preceding sentence and subparagraph (C), a qualified 501(c)(3) bond (as defined in section 145) shall not be treated as a private activity bond.

"(C) LIMITATION ON ISSUER.—An obligation issued by an issuer during any calendar year shall not be treated as a qualified tax-exempt obligation unless the reasonably anticipated amount of qualified tax-exempt obligations (other than private activity bonds) which will be issued by such issuer during such calendar year does not exceed $10,000,000.

"(D) OVERALL $10,000,000 LIMITATION.—Not more than $10,000,000 of obligations issued by an issuer during any calendar year may be designated by such issuer for purposes of this paragraph.

"(E) AGGREGATION OF ISSUERS.—For purposes of subparagraphs (C) and (D), an issuer and all subordinate entities thereof shall be treated as 1 issuer.

"(4) DEFINITIONS.—For purposes of this subsection—

"(A) INTEREST EXPENSE.—The term 'interest expense' means the aggregate amount allowable to the taxpayer as a deduction for interest for the taxable year (determined without regard to this subsection and section 291). For purposes of the preceding sentence, the term 'interest' includes amounts (whether or not designated as interest) paid in respect of deposits, investment certificates, or withdrawable or repurchasable shares.

"(B) TAX-EXEMPT OBLIGATION.—The term 'tax-exempt obligation' means any obligation the interest on which is wholly exempt from taxes imposed by this subtitle. Such term includes shares of stock of a regulated investment company which during the taxable year of the holder thereof distributes exempt-interest dividends.

"(5) FINANCIAL INSTITUTION.—For purposes of this subsection, the term 'financial institution' means any person who—

"(A) accepts deposits from the public in the ordinary course of such person's trade or business, and is subject to Federal or State supervision as a financial institution, or

"(B) is a corporation described in section 585(a)(2).

"(6) SPECIAL RULES.—

"(A) COORDINATION WITH SUBSECTION (a).—If interest on any indebtedness is disallowed under subsection (a) with respect to any tax-exempt obligation—

"(i) such disallowed interest shall not be taken into account for purposes of applying this subsection, and

"(ii) for purposes of applying paragraph (2), the adjusted basis of such tax-exempt obligation shall be reduced (but not below zero) by the amount of such indebtedness.

"(B) COORDINATION WITH SECTION 263A.—This section shall be applied before the application of section 263A (relating to capitalization of certain expenses where taxpayer produces property)."

(b) REPEAL OF SPECIAL TREATMENT FOR CERTAIN FINANCIAL INSTITUTIONS.—Paragraph (2) of section 265 (as in effect on the day before the date of the enactment of this Act) is amended by striking out the second sentence.

(c) TERMINATION OF REDUCTION IN DEDUCTION FOR INTEREST ALLOCABLE TO TAX-EXEMPT OBLIGATIONS UNDER SECTION 291.—

(1) IN GENERAL.—Clause (i) of section 291(e)(1)(B) (relating to interest on debt to carry tax-exempt obligations acquired after December 31, 1982) is amended by striking out "after December 31, 1982" and inserting in lieu thereof "after December 31, 1982, and before August 8, 1986".

(2) TECHNICAL AMENDMENTS.—Subparagraph (B) of section 291(e)(1) is amended—

(A) by striking out "(but for this paragraph)" in clause (i) and inserting in lieu thereof "(but for this paragraph or section 265(b))",

(B) by striking out "without regard to this section" in clause (ii) and inserting in lieu thereof "without regard to this section and section 265(b)",

(C) by striking out "AFTER DECEMBER 31, 1982" in the subparagraph heading and inserting in lieu thereof "AFTER DECEMBER 31, 1982, AND BEFORE AUGUST 8, 1986", and

(D) by adding at the end thereof the following new clause:

"(iv) APPLICATION OF SUBPARAGRAPH TO CERTAIN OBLIGATIONS ISSUED AFTER AUGUST 7, 1986.—

"For application of this subparagraph to certain obligations issued after August 7, 1986, see section 265(b)(3)."

(d) CLERICAL AMENDMENT.—Section 265 is amended by striking out "No deduction shall be allowed for—" and inserting in lieu thereof the following:

"(a) GENERAL RULE.—No deduction shall be allowed for—".

(e) CONFORMING AMENDMENTS.—

(1) Section 163(h)(12) is amended by striking out "section 265(2)" and inserting in lieu thereof "section 265(a)(2).

(2) Section 1277(c) is amended by striking out "section 265(5)" and inserting in lieu thereof "section 265(a)(5)".

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to taxable years ending after December 31, 1986.

(2) OBLIGATIONS ACQUIRED PURSUANT TO CERTAIN COMMITMENTS.—For purposes of sections 265(b) and 291(e)(1)(B) of the Internal Revenue Code of 1986, any tax-exempt obligation which is acquired after August 7, 1986, pursuant to a direct or indirect written commitment—

(A) to purchase or repurchase such obligation, and

(B) entered into on or before September 25, 1985,

shall be treated as an obligation acquired before August 8, 1986.

(3) TRANSITIONAL RULES.—For purposes of sections 265(b) and 291(e)(1)(B) of the Internal Revenue Code of 1986, obligations with respect to any of the following projects shall be treated as obligations acquired before August 8, 1986, in the hands of the first and any subsequent financial institution acquiring such obligations:

(A) Park Forest, Illinois, redevelopment project.

(B) Clinton, Tennessee, Carriage Trace project.

(C) Savannah, Georgia, Mall Terrace Warehouse project.

(D) Chattanooga, Tennessee, Warehouse Row project.

(E) Dalton, Georgia, Towne Square project.

(F) Milwaukee, Wisconsin, Standard Electric Supply Company—distribution company.

(G) Wausau, Wisconsin, urban renewal project.

(H) Cassville, Missouri, UDAG project.

(I) Outlook Envelope Company—plant expansion.

(J) Woodstock, Connecticut, Crabtree Warehouse partnership.

(K) Louisville, Kentucky, Speed Mansion renovation project.

(L) Charleston, South Carolina, waterfront project.

(M) New Orleans, Lousiana, Upper Pontabla Building renovation.

(N) Woodward Wight Building.

(O) Minneapolis, Minnesota, Miller Milling Company—flour mill project.

(P) Birmingham, Alabama, Club Apartments.

(Q) Charlotte, North Carolina—qualified mortgage bonds acquired by NCNB bank ($5,250,000).

(R) Grand Rapids, Michigan, Central Bank project.

(S) Ruppman Marketing Services, Inc.—building project.

(4) ADDITIONAL TRANSITIONAL RULE.—Obligations issued pursuant to an allocation of a State's volume limitation for private activity bonds, which allocation was made by Executive Order 25 signed by the Governor of the State on May 22, 1986 (as such order may be amended before January 1, 1987), shall be treated as acquired on or before August 7, 1986, in the hands of the first and any subsequent financial institution acquiring such

obligation. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $200,000,000.

SEC. 903. TERMINATION OF SPECIAL 10-YEAR CARRYBACK RULES FOR CERTAIN FINANCIAL INSTITUTIONS; NEW SPECIAL CARRYOVER RULES FOR CERTAIN LOSSES.

(a) TERMINATION OF SPECIAL 10-YEAR CARRYBACK RULES FOR CERTAIN FINANCIAL INSTITUTIONS.—

(1) Subparagraph (F) of section 172(b)(1) (relating to years to which loss may be carried) is amended by striking out "after December 31, 1975," and inserting in lieu thereof "after December 31, 1975, and before January 1, 1987,".

(2) Subparagraph (G) of section 172(b)(1) is amended by striking out "after December 31, 1969," and inserting in lieu thereof "after December 31, 1969, and before January 1, 1987,".

(3) Subparagraph (H) of section 172(b)(1) is amended—

(A) by striking out "after December 31, 1981," and inserting in lieu thereof "after December 31, 1981, and before January 1, 1987,", and

(B) by striking out "after December 31, 1984," and inserting in lieu thereof "after December 31, 1984, and before January 1, 1987,".

(b) SPECIAL 10-YEAR CARRYBACK FOR BAD DEBT LOSSES OF COMMERCIAL BANKS; ADDITIONAL 3-YEAR CARRYFORWARD FOR LOSSES OF THRIFT INSTITUTIONS.—

(1) IN GENERAL.—Paragraph (1) of section 172(b) (relating to year to which loss may be carried) is amended by adding at the end thereof the following new subparagraphs:

"(L) BAD DEBT LOSSES OF COMMERCIAL BANKS.—In the case of any bank (as defined in section 585(a)(2)), the portion of the net operating loss for any taxable year beginning after December 31, 1986, and before January 1, 1994, which is attributable to the deduction allowed under section 166(a) shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of the loss and a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

"(M) LOSSES OF THRIFT INSTITUTIONS.—In the case of an organization to which section 593 applies, in lieu of applying subparagraph (F), a net operating loss for any taxable year beginning after December 31, 1981, and before January 1, 1986, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 8 taxable years following the taxable year of such loss."

(2) TECHNICAL AMENDMENTS.—

(A) Subparagraph (A) of section 172(b)(1) is amended by striking out "and (K)" and inserting in lieu thereof "(K), (L), and (M)".

(B) Subparagraph (B) of section 172(b)(1) is amended by striking out "and (J)" and inserting in lieu thereof "(J), (L), and (M)".

(C) Section 172 is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:

"(l) Rules Relating to Bad Debt Losses of Commercial Banks.—For purposes of this section—

"(1) Portion attributable to deduction for bad debts.—The portion of the net operating loss for any taxable year which is attributable to the deduction allowed under section 166(a) shall be the excess of—

"(i) the net operating loss for such taxable year, over

"(ii) the net operating loss for such taxable year determined without regard to the amount allowed as a deduction under section 166(a) for such taxable year.

"(2) Coordination with subsection (b)(2).—In applying paragraph (2) of subsection (b), the portion of the net operating loss for any taxable year which is attributable to the deduction allowed under section 166(a) shall be treated in a manner similar to the manner in which a foreign expropriation loss is treated."

(c) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to losses incurred in taxable years beginning after December 31, 1986.

(2) Additional carryforward period for losses of thrift institutions.—Subparagraph (M) of section 172(b)(1) of the Internal Revenue Code of 1986 (as added by this section) shall apply to losses incurred in taxable years beginning after December 31, 1981.

SEC. 904. REPEAL OF SPECIAL REORGANIZATION RULES FOR FINANCIAL INSTITUTIONS.

(a) General Rule.—Subparagraph (D) of section 368(a)(3) (relating to agency receivership proceedings which involve financial institutions) is amended to read as follows:

"(D) Agency receivership proceedings which involve financial institutions.—For purposes of subparagraphs (A) and (B), in the case of a receivership, foreclosure, or similar proceeding before a Federal or State agency involving a financial institution referred to in section 581 or 591, the agency shall be treated as a court."

(b) Repeal of Special Treatment for FSLIC Financial Assistance.—

(1) Section 597 (relating to FSLIC financial assistance) is hereby repealed.

(2) The table of sections for part II of subchapter H of chapter 1 is amended by striking out the item relating to section 597.

(c) Effective Dates.—

(1) Subsection (a).—The amendments made by subsection (a) shall apply to acquisitions after December 31, 1988, in taxable years ending after such date.

(2) Subsection (b).—

(A) In general.—The amendments made by subsection (b) shall apply to transfers after December 31, 1988, in taxable years ending after such date; except that such amendments shall not apply to transfers after such date pursuant to an acquisition to which the amendments made by subsection (a) do not apply.

(B) Clarification of treatment of amounts excluded under section 597.—Section 265(a)(1) of the Internal Revenue Code of 1986 (as amended by this title) shall not deny any deduction by reason of such deduction being allocable to amounts excluded from gross income under section 597 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act).

SEC. 905. TREATMENT OF LOSSES ON DEPOSITS OR ACCOUNTS IN INSOLVENT FINANCIAL INSTITUTIONS.

(a) In General.—Section 165 (relating to losses) is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:

"(l) Treatment of Certain Losses in Insolvent Financial Institutions.—

"(1) In general.—If—

"(A) as of the close of the taxable year, it can reasonably be estimated that there is a loss on a qualified individual's deposit in a qualified financial institution, and

"(B) such loss is on account of the bankruptcy or insolvency of such institution,

then the taxpayer may elect to treat the amount so estimated as a loss described in subsection (c)(3) incurred during the taxable year.

"(2) Qualified individual defined.—For purposes of this subsection, the term 'qualified individual' means any individual, except an individual—

"(A) who owns at least 1 percent in value of the outstanding stock of the qualified financial institution,

"(B) who is an officer of the qualified financial institution,

"(C) who is a sibling (whether by the whole or half blood), spouse, aunt, uncle, nephew, niece, ancestor, or lineal descendant of an individual described in subparagraph (A) or (B), or

"(D) who otherwise is a related person (as defined in section 267(b)) with respect to an individual described in subparagraph (A) or (B).

"(3) Qualified financial institution.—For purposes of this subsection, the term 'qualified financial institution' means—

"(A) any bank (as defined in section 581),

"(B) any institution described in section 591,

"(C) any credit union the deposits or accounts in which are insured under Federal or State law or are protected or guaranteed under State law, or

"(D) any similar institution chartered and supervised under Federal or State law.

"(4) Deposit.—For purposes of this subsection, the term 'deposit' means any deposit, withdrawable account, or withdrawable or repurchasable share.

"(5) Election.—Any election by the taxpayer under this subsection may be revoked only with the consent of the Secretary and shall apply to all losses of the taxpayer on deposits in the institution with respect to which such election was made.

"(6) COORDINATION WITH SECTION 166.—Section 166 shall not apply to any loss to which an election under this subsection applies.".

(b) INTEREST ON FROZEN DEPOSITS.—Section 451 (relating to general rule for taxable year of inclusion) is amended by adding at the end thereof the following new subsection:

"(f) TREATMENT OF INTEREST ON FROZEN DEPOSITS IN CERTAIN FINANCIAL INSTITUTIONS.—

"(1) IN GENERAL.—In the case of interest credited during any calendar year on a frozen deposit in a qualified financial institution, the amount of such interest includible in the gross income of a qualified individual shall not exceed the sum of—

"(A) the net amount withdrawn by such individual from such deposit during such calendar year, and

"(B) the amount of such deposit which is withdrawable as of the close of the taxable year (determined without regard to any penalty for premature withdrawals of a time deposit).

"(2) INTEREST TESTED EACH YEAR.—Any interest not included in gross income by reason of paragraph (1) shall be treated as credited in the next calendar year.

"(3) DEFERRAL OF INTEREST DEDUCTION.—No deduction shall be allowed to any qualified financial institution for interest not includible in gross income under paragraph (1) until such interest is includible in gross income.

"(4) FROZEN DEPOSIT.—For purposes of this subsection, the term 'frozen deposit' means any deposit if, as of the close of the calendar year, any portion of such deposit may not be withdrawn because of—

"(A) the bankruptcy or insolvency of the qualified financial institution (or threat thereof), or

"(B) any requirement imposed by the State in which such institution is located by reason of the bankruptcy or insolvency (or threat thereof) of 1 or more financial institutions in the State.

"(5) OTHER DEFINITIONS.—For purposes of this subsection, the terms 'qualified individual', 'qualified financial institution', and 'deposit' have the same respective meanings as when used in section 165(l)."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1982.

(2) SPECIAL RULES FOR SUBSECTION (b).—

(A) The amendment made by subsection (b) shall apply to taxable years beginning after December 31, 1982, and before January 1, 1987, only if the qualified individual elects to have such amendment apply for all such taxable years.

(B) In the case of interest attributable to the period beginning January 1, 1983, and ending December 31, 1987, the interest deduction of financial institutions shall be determined without regard to paragraph (3) of section 451(f) of the Internal Revenue Code of 1986 (as added by subsection (b)).

TITLE X—INSURANCE PRODUCTS AND COMPANIES

Subtitle A—Policyholder Issues

SEC. 1001. REPEAL OF EXCLUSION FOR INTEREST ON INSTALLMENT PAYMENTS OF LIFE INSURANCE PROCEEDS.

(a) In General.—The second sentence of paragraph (1) of section 101(d) (relating to payment of life insurance proceeds at a date later than death) is amended to read as follows: "There shall be excluded from the gross income of such beneficiary in the taxable year received any amount determined by such proration."

(b) Determination of Amount Held by Insurer.—Clause (ii) of section 101(d)(2)(B) is amended to read as follows:

> *"(ii) as discounted on the basis of the interest rate used by the insurer in calculating payments under the agreement and mortality tables prescribed by the Secretary."*

(c) Technical Amendments.—

(1) Subsection (d) of section 101 is amended by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3).

(2) Subparagraph (B) of section 101(d)(2) is amended by striking out "is equal" and inserting in lieu thereof "equal".

(d) Effective Date.—The amendments made by this section shall apply to amounts received with respect to deaths occurring after the date of the enactment of this section in taxable years ending after such date.

SEC. 1002. EXCLUSION FROM INCOME WITH RESPECT TO STRUCTURED SETTLEMENTS LIMITED TO CASES INVOLVING PHYSICAL INJURY.

(a) In General.—Subsection (c) of section 130 (relating to certain personal insurance liability assignments) is amended by inserting "(in a case involving physical injury or physical sickness)" after "personal injury or sickness".

(b) Effective Date.—The amendment made by this section shall apply to assignments entered into after December 31, 1986, in taxable years ending after such date.

SEC. 1003. DENIAL OF DEDUCTION FOR INTEREST ON LOANS FROM CERTAIN LIFE INSURANCE CONTRACTS.

(a) In General.—Section 264(a) (relating to disallowance of deduction for certain amounts paid in connection with insurance contracts) is amended by adding after paragraph (3) the following new paragraph:

> *"(4) Any interest paid or accrued on any indebtedness with respect to 1 or more life insurance policies owned by the taxpayer covering the life of any individual who—*
>
> *"(A) is an officer or employee of, or*
>
> *"(B) is financially interested in,*
>
> *any trade or business carried on by the taxpayer to the extent that the aggregate amount of such indebtedness with respect to policies covering such individual exceeds $50,000."*

(b) Conforming Amendment.—Section 264(a) is amended by adding at the end thereof the following new sentence: "Paragraph (4) shall apply with respect to contracts purchased after June 20, 1986."

(c) Effective Date.—The amendments made by this section shall apply to contracts purchased after June 20, 1986, in taxable years ending after such date.

SEC. 1004. DEDUCTION FOR NONBUSINESS CASUALTY LOSSES COVERED BY INSURANCE ALLOWABLE ONLY IF CLAIM FILED.

(a) In General.—Paragraph (4) of section 165(h) (relating to treatment of casualty gains and losses) is amended by adding at the end thereof the following new subparagraph:

> *"(E) Claim required to be filed in certain cases.—Any loss of an individual described in subsection (c)(3) to the extent covered by insurance shall be taken into account under this section only if the individual files a timely insurance claim with respect to such loss."*

(b) Effective Date.—The amendment made by this section shall apply to losses sustained in taxable years beginning after December 31, 1986.

Subtitle B—Life Insurance Companies

SEC. 1011. REPEAL OF SPECIAL LIFE INSURANCE COMPANY DEDUCTION.

(a) In General.—Section 806 is amended by striking out subsection (a) and by redesignating subsections (b), (c), and (d), as subsections (a), (b), and (c), respectively.

(b) Technical and Conforming Amendments.—

(1) Sections 453B(e)(2)(B) and 465(c)(7)(D)(v) are each amended by striking out "section 806(c)(3)" and inserting in lieu thereof "section 806(b)(3)".

(2) Section 804 is amended by adding "and" at the end of paragraph (1) and by striking out paragraphs (2) and (3) and inserting in lieu thereof the following:

"(2) the small life insurance company deduction (if any) determined under section 806(a)."

(3) Subparagraph (C) of section 801(a)(2) is amended—

(A) by striking out "the amounts allowable as deductions under paragraphs (2) and (3)" and inserting in lieu thereof "the amount allowable as a deduction under paragraph (2)", and

(B) by striking out "SPECIAL LIFE INSURANCE COMPANY DEDUCTION AND" in the heading.

(4) Clause (i) of section 805(a)(4)(B) and clause (iii) of section 805(b)(3)(A) are each amended by striking out "the special life insurance company deduction and".

(5) Paragraph (1) of section 806(b), as redesignated by subsection (a), is amended by striking out "without regard to—" and all that follows and inserting in lieu thereof "without regard to the small life insurance company deduction."

(6) Paragraph (1) of section 806(c), as redesignated by subsection (a), is amended—

(A) by striking out "subsections (a) and (b)" and inserting in lieu thereof "subsection (a)",

(B) by striking out "any special life insurance company deduction and", and

(C) by striking out "SPECIAL LIFE INSURANCE COMPANY DEDUCTION AND SMALL" in the heading and inserting in lieu thereof "SMALL".

(7) Paragraph (2) of section 806(c), as redesignated by subsection (a), is amended by striking out "subsection (b)(3)" and inserting in lieu thereof "subsection (a)(3)".

(8) Subsection (c) of section 806, as redesignated by subsection (a), is amended by striking out paragraph (4) and by redesignating paragraph (5) as paragraph (4).

(9) Subparagraph (A) of section 813(a)(4) is amended by striking out "section 806(b)(3)(C)" and inserting in lieu thereof "section 806(a)(3)(C)".

(10) Clause (ii) of section 815(c)(2)(A) is amended by striking out "special deductions" and inserting in lieu thereof "small life insurance company deduction."

*(11)(A) The section heading of section 806 is amended by striking out **"SPECIAL DEDUCTIONS"** and inserting in lieu thereof **"SMALL LIFE INSURANCE COMPANY DEDUCTION"**.*

(B) The table of sections for subpart C of part I of subchapter L of chapter 1 is amended by striking out "Special deductions" in the item relating to section 806 and inserting in lieu thereof "Small life insurance company deduction".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) SPECIAL RULE.—Section 217(k) of the Tax Reform Act of 1984 is amended—

(A) by striking out "the special deductions under section 806" and inserting in lieu thereof "the small life insurance company deduction under section 806(a)", and

(B) by adding at the end thereof the following: "For purposes of determining taxable income, the amount of any income, gain, loss, or deduction attributable to the ownership of such stock shall be an amount equal to 46 times the amount of such income, gain, loss, or deduction, divided by 36.8."

(d) TREATMENT OF CERTAIN MARKET DISCOUNT BONDS.—

(1) IN GENERAL.—Notwithstanding the amendments made by subtitle B of title III, any gain recognized by a qualified life insurance company on the redemption at maturity of any bond which was issued before July 19, 1984, and acquired by such company on or before September 25, 1985, shall be subject to tax at the rate of 28 percent.

(2) QUALIFIED LIFE INSURANCE COMPANY.—For purposes of paragraph (1), the term 'qualified life insurance company' means any of the following companies: Aetna, Provident Life and Accident, Massachusetts Mutual, Mutual Benefit, Connecticut Mutual, Phoenix Mutual, John Hancock, New England Life, Pennsylvania Mutual, Transamerica, Northwestern, Provident Mutual, Prudential, Mutual of Omaha, and Metropolitan.

SEC. 1012. REPEAL OF TAX-EXEMPT STATUS FOR CERTAIN ORGANIZATIONS PROVIDING COMMERCIAL-TYPE INSURANCE.

(a) IN GENERAL.—Section 501 (relating to exemption from tax on corporations, certain trusts, etc.) is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following new subsection:

"(m) CERTAIN ORGANIZATIONS PROVIDING COMMERCIAL-TYPE INSURANCE NOT EXEMPT FROM TAX.—

"(1) DENIAL OF TAX EXEMPTION WHERE PROVIDING COMMERCIAL-TYPE INSURANCE IS SUBSTANTIAL PART OF ACTIVITIES.—An organization described in paragraph (3) or (4) of subsection (c) shall be exempt from tax under subsection (a) only if no substantial part of its activities consists of providing commercial-type insurance.

"(2) OTHER ORGANIZATIONS TAXED AS INSURANCE COMPANIES ON INSURANCE BUSINESS.—In the case of an organization described in paragraph (3) or (4) of subsection (c) which is exempt from tax under subsection (a) after the application of paragraph (1) of this subsection—

"(A) the activity of providing commercial-type insurance shall be treated as an unrelated trade or business (as defined in section 513), and

"(B) in lieu of the tax imposed by section 511 with respect to such activity, such organization shall be treated as an insurance company for purposes of applying subchapter L with respect to such activity.

"(3) COMMERCIAL-TYPE INSURANCE.—For purposes of this subsection, the term 'commercial-type insurance' shall not include—

"(A) insurance provided at substantially below cost to a class of charitable recipients,

"(B) incidental health insurance provided by a health maintenance organization of a kind customarily provided by such organizations, and

"(C) property or casualty insurance provided (directly or through an organization described in section 414(e)(3)(B)(ii)) by a church or convention or association of churches for such church or convention or association of churches, and

"(D) providing retirement or welfare benefits (or both) by a church or a convention or association of churches (directly or through an organization described in section 414(e)(3)(A) or 414(e)(3)(B)(ii)) for the employees (including employees described in section 414(e)(3)(B)) of such church or convention or association of churches or the beneficiaries of such employees.

"(4) INSURANCE INCLUDES ANNUITIES.—For purposes of this subsection, the issuance of annuity contracts shall be treated as providing insurance."

(b) TREATMENT OF BLUE CROSS AND BLUE SHIELD ORGANIZATIONS AND SIMILAR ORGANIZATIONS.—

(1) IN GENERAL.—Part III of subchapter L of chapter 1 is amended by adding at the end thereof the following new section:

"SEC. 833. TREATMENT OF BLUE CROSS AND BLUE SHIELD ORGANIZATIONS, ETC.

"(a) GENERAL RULE.—In the case of any organization to which this section applies—

"(1) TREATED AS STOCK COMPANY.—Such organization shall be taxable under this part in the same manner as if it were a stock insurance company.

"(2) SPECIAL DEDUCTION ALLOWED.—The deduction determined under subsection (b) for any taxable year shall be allowed.

"(3) REDUCTIONS IN UNEARNED PREMIUM RESERVES NOT TO APPLY.—Subparagraph (B) of paragraph (4) of section 832(b) shall be applied by substituting '100 percent' for '80 percent', and subparagraph (C) of such paragraph (4) shall not apply.

"(b) AMOUNT OF DEDUCTION.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the deduction determined under this subsection for any taxable year is the excess (if any) of—

"(A) 25 percent of the sum of—

"(i) the claims incurred during the taxable year, and

"(ii) the expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims, over

"(B) the adjusted surplus as of the beginning of the taxable year.

"(2) LIMITATION.—The deduction determined under paragraph (1) for any taxable year shall not exceed taxable income for such taxable year (determined without regard to such deduction).

"(3) ADJUSTED SURPLUS.—For purposes of this subsection—

"(A) IN GENERAL.—The adjusted surplus as of the beginning of any taxable year is an amount equal to the adjusted surplus as of the beginning of the preceding taxable year—

"(i) increased by the amount of any adjusted taxable income for such preceding taxable year, or

"(ii) decreased by the amount of any adjusted net operating loss for such preceding taxable year.

"(B) SPECIAL RULE.—The adjusted surplus as of the beginning of the organization's 1st taxable year beginning after December 31, 1986, shall be its surplus as of such time. For purposes of the preceding sentence and subsection (c)(3)(C), the term 'surplus' means the excess of the total assets over total liabilities as shown on the annual statement.

"(C) ADJUSTED TAXABLE INCOME.—The term 'adjusted taxable income' means taxable income determined—

"(i) without regard to the deduction determined under this subsection,

"(ii) without regard to any carryforward or carryback to such taxable year, and

"(iii) by increasing gross income by an amount equal to the net exempt income for the taxable year.

"(D) ADJUSTED NET OPERATING LOSS.—The term 'adjusted net operating loss' means the net operating loss for any taxable year determined with the adjustments set forth in subparagraph (C).

"(E) NET EXEMPT INCOME.—The term 'net exempt income' means—

"(i) any tax-exempt interest received or accrued during the taxable year, reduced by any amount (not otherwise deductible) which would have been allowable as a deduction for the taxable year if such interest were not tax-exempt, and

"(ii) the aggregate amount allowed as a deduction for the taxable year under sections 243, 244, and 245.

The amount determined under clause (ii) shall be reduced by the amount of any decrease in deductions allowable for the taxable year by reason of section 832(b)(5)(B) to the extent such decrease is attributable to deductions under sections 243, 244, and 245.

"(4) ONLY HEALTH-RELATED ITEMS TAKEN INTO ACCOUNT.—Any determination under this subsection shall be made by only taking into account items attributable to the health-related business of the taxpayer.

"(c) ORGANIZATIONS TO WHICH SECTION APPLIES.—

"(1) IN GENERAL.—This section shall apply to—

"(A) any existing Blue Cross or Blue Shield organization, and

"(B) any other organization meeting the requirements of paragraph (3).

"(2) EXISTING BLUE CROSS OR BLUE SHIELD ORGANIZATION.—The term 'existing Blue Cross or Blue Shield organization' means any Blue Cross or Blue Shield organization if—

"(A) such organization was in existence on August 16, 1986,

"(B) such organization is determined to be exempt from tax for its last taxable year beginning before January 1, 1987, and

"(C) no material change has occurred in the operations of such organization or in its structure after August 16, 1986, and before the close of the taxable year.

To the extent permitted by the Secretary, any successor to an organization meeting the requirements of the preceding sentence, and any organization resulting from the merger or consolidation of organizations each of which met such requirements, shall be treated as an existing Blue Cross or Blue Shield organization.

"(3) OTHER ORGANIZATIONS.—

"(A) IN GENERAL.—An organization meets the requirements of this paragraph for any taxable year if—

"(i) substantially all the activities of such organization involve the providing of health insurance,

"(ii) at least 10 percent of the health insurance provided by such organization is provided to individuals and small groups (not taking into account any medicare supplemental coverage),

"(iii) such organization provides continuous full-year open enrollment (including conversions) for individuals and small groups,

"(iv) such organization's policies covering individuals provide full coverage of pre-existing conditions of high-risk individuals without a price differential (with a reasonable waiting period), and coverage is provided without regard to age, income, or employment status of individuals under age 65,

"(v) at least 35 percent of its premiums are determined on a community rated basis, and

"(vi) no part of its net earnings inures to the benefit of any private shareholder or individual.

"(B) SMALL GROUP DEFINED.—For purposes of subparagraph (A), the term 'small group' means the lesser of—

"(i) 15 individuals, or

"(ii) the number of individuals required for a small group under applicable State law.

"(C) SPECIAL RULE FOR DETERMINING ADJUSTED SURPLUS.—For purposes of subsection (b), the adjusted surplus of any organization meeting the requirements of this paragraph as of the beginning of the 1st taxable year for which it meets such requirements shall be its surplus as of such time."

(2) CLERICAL AMENDMENT.—The table of sections for such part III is amended by adding at the end thereof the following new item:

"Sec. 833. Treatment of Blue Cross and Blue Shield organizations, etc."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) STUDY OF FRATERNAL BENEFICIARY ASSOCIATIONS.—The Secretary of the Treasury or his delegate shall conduct a study of organizations described in section 501(c)(8) of the Internal Revenue Code of 1986 and which received gross annual insurance premiums in excess of $25,000,000 for the taxable years of such organizations which ended during 1984. Not later than January 1, 1988, the Secretary of the Treasury shall submit to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, and the Joint Committee on Taxation the results of such study, together with such recommendations as he determines to be appropriate. The Secretary of the Treasury shall have authority to require the furnishing of such information as may be necessary to carry out the purposes of this paragraph.

(3) SPECIAL RULES FOR EXISTING BLUE CROSS OR BLUE SHIELD ORGANIZATIONS.—

(A) IN GENERAL.—In the case of any existing Blue Cross or Blue Shield organization (as defined in section 833(c)(2) of the Internal Revenue Code of 1986 as added by this section)—

(i) no adjustment shall be made under section 481 (or any other provision) of such Code on account of a change in its method of accounting for its 1st taxable year beginning after December 31, 1986, and

(ii) for purposes of determining gain or loss, the adjusted basis of any asset held on the 1st day of such taxable year shall be treated as equal to its fair market value as of such day.

(B) TREATMENT OF CERTAIN DISTRIBUTIONS.—For purposes of section 833(b)(3)(B), the surplus of any organization as of the beginning of its 1st taxable year beginning after December 31, 1986, shall be increased by the amount of any distribution (other than to policyholders) made by such organization after August 16, 1986, and before the beginning of such taxable year.

(C) RESERVE WEAKENING AFTER AUGUST 16, 1986.—Any reserve weakening after August 16, 1986, by an existing Blue Cross or Blue Shield organization shall be treated as occurring in such organization's 1st taxable year beginning after December 31, 1986.

(4) OTHER SPECIAL RULES.—

(A) The amendments made by this section shall not apply with respect to that portion of the business of Mutual of America which is attributable to pension business.

(B) The amendments made by this section shall not apply to that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund which is attributable to pension business.

(C) The amendments made by this section shall not apply to—

(i) the retirement fund of the YMCA,

(ii) the Missouri Hospital Association,

(iii) administrative services performed by municipal leagues, and

(iv) dental benefit coverage provided by Delta Dental Plans Association through contracts with independent professional service providers so long as the provision of such coverage is the principal activity of such Association.

(D) For purposes of this paragraph, the term "pension business" means the administration of any plan described in section 401(a) of the Internal Revenue Code of 1954 which includes a trust exempt from tax under section 501(a), any plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b) of such Code, any individual retirement plan described in section 408 of such Code, and any eligible deferred compensation plan to which section 457(a) of such Code applies.

SEC. 1013. OPERATIONS LOSS DEDUCTION OF INSOLVENT COMPANIES MAY OFFSET DISTRIBUTIONS FROM POLICYHOLDERS SURPLUS ACCOUNT.

(a) IN GENERAL.—If—

(1) on November 15, 1985, a life insurance company was insolvent,

(2) pursuant to the order of any court of competent jurisdiction in a title 11 or similar case (as defined in section 368(a)(3) of the Internal Revenue Code of 1954), such company is liquidated, and

(3) as a result of such liquidation, the tax imposed by section 801 of such Code for any taxable year (hereinafter in this subsection referred to as the "liquidation year") would (but for this subsection) be increased under section 815(a) of such Code,

then the amount described in section 815(a)(2) of such Code shall be reduced by the loss from operations (if any) for the liquidation year, and by the unused operations loss carryovers (if any) to the liquidation year (determined after the application of section 810 of such Code for such year). No carryover of any loss from operations of such company arising during the liquidation year (or any prior taxable year) shall be allowable for any taxable year succeeding the liquidation year.

(b) DEFINITIONS.—For purposes of subsection (a)—

(1) INSOLVENT.—The term "insolvent" means the excess of liabilities over the fair market value of assets.

(2) LOSS FROM OPERATIONS.—The term "loss from operations" has the meaning given such term by section 810(c) of such Code.

(c) EFFECTIVE DATE.—This section shall apply to liquidations on or after November 15, 1985, in taxable years ending after such date.

Subtitle C—Property and Casualty Insurance Companies

SEC. 1021. INCLUSION IN INCOME OF 20 PERCENT OF UNEARNED PREMIUM RESERVE.

(a) IN GENERAL.—The first sentence of paragraph (4) of section 832(b) (defining premiums earned) is amended by striking out subparagraph (B) and inserting in lieu thereof the following:

"(B) To the result so obtained, add 80 percent of the unearned premiums on outstanding business at the end of the preceding taxable year and deduct 80 percent of the unearned premiums on outstanding business at the end of the taxable year.

"(C) To the result so obtained, in the case of a taxable year beginning after December 31, 1986, and before January 1, 1993, add an amount equal to 3⅓ percent of unearned premiums on outstanding business at the end of the most recent taxable year beginning before January 1, 1987."

(b) SPECIAL RULES.—Subsection (b) of section 832 is amended by adding at the end thereof the following new paragraph:

"(7) SPECIAL RULES FOR APPLYING PARAGRAPH (4).—

"(A) REDUCTION NOT TO APPLY TO LIFE INSURANCE RESERVES.—Subparagraph (B) of paragraph (4) shall be applied with respect to amounts included in unearned premiums under the 2nd sentence of such paragraph by substituting '100 percent' for '80 percent' each place it appears in such subparagraph (B), and subparagraph (C) of paragraph

(4) shall be applied by not taking such amounts into account.

"(B) SPECIAL TREATMENT OF PREMIUMS ATTRIBUTABLE TO INSURING CERTAIN SECURITIES.—In the case of premiums attributable to insurance against default in the payment of principal or interest on securities described in section 165(g)(2)(C) with maturities of more than 5 years—

"(i) subparagraph (B) of paragraph (4) shall be applied by substituting '90 percent' for '80 percent' each place it appears, and

"(ii) subparagraph (C) of paragraph (4) shall be applied by substituting '1⅔ percent' for '3⅓ percent'.

"(C) TERMINATION AS NONLIFE INSURANCE COMPANY.—Except as provided in section 381(c)(22) (relating to carryovers in certain corporate readjustments), if, for any taxable year beginning before January 1, 1993, the taxpayer ceases to be an insurance company taxable under this part, the aggregate adjustments which would be made under paragraph (4)(C) for such taxable year and subsequent taxable years but for such cessation shall be made for the taxable year preceding such cessation year.

"(8) SPECIAL RULES FOR APPLYING PARAGRAPH (4) TO TITLE INSURANCE PREMIUMS.—

"(A) IN GENERAL.—In the case of premiums attributable to title insurance—

"(i) subparagraph (B) of paragraph (4) shall be applied by substituting 'the discounted unearned premiums' for '80 percent of the unearned premiums' each place it appears, and

"(ii) subparagraph (C) of paragraph (4) shall not apply.

"(B) METHOD OF DISCOUNTING.—For purposes subparagraph (A), the amount of the discounted unearned premiums as of the end of any taxable year shall be the present value of such premiums (as of such time and separately with respect to premiums received in each calendar year) determined by using—

"(i) the amount of the undiscounted unearned premiums at such time,

"(ii) the applicable interest rate, and

"(iii) the applicable statutory premium recognition pattern.

"(C) DETERMINATION OF APPLICABLE FACTORS.—In determining the amount of the discounted unearned premiums as of the end of any taxable year—

"(i) UNDISCOUNTED UNEARNED PREMIUMS.—The term 'undiscounted unearned premiums' means the unearned premiums shown in the yearly statement filed by the taxpayer for the year ending with or within such taxable year.

"(ii) APPLICABLE INTEREST RATE.—The term 'applicable interest rate' means the annual rate determined under 846(c)(2) for the calendar year in which the premiums are received.

"(iii) Applicable statutory premium recognition pattern.—The term 'applicable statutory premium recognition pattern' means the statutory premium recognition pattern—

"(I) which is in effect for the calendar year in which the premiums are received, and

"(II) which is based on the statutory premium recognition pattern which applies to premiums received by the taxpayer in such calendar year.

For purposes of the preceding sentence, premiums received during any calendar year shall be treated as received in the middle of such year."

(c) Effective Date.—

(1) In general.—The amendment made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Special transitional rule for title insurance companies.—For the 1st taxable year beginning after December 31, 1986, in the case of premiums attributable to title insurance—

(A) In general.—The unearned premiums at the end of the preceding taxable year as defined in paragraph (4) of section 832(b) shall be determined as if the amendments made by this section had applied to such unearned premiums in the preceding taxable year and by using the interest rate and premium recognition pattern applicable to years ending in calendar year 1987.

(B) Fresh start.—Except as provided in subparagraph (C), any difference between—

(i) the amount determined to be unearned premiums for the year preceding the first taxable year of a title insurance company beginning after December 31, 1986, determined without regard to subparagraph (A), and

(ii) such amount determined with regard to subparagraph (A),

shall not be taken into account for purposes of the Internal Revenue Code of 1986.

(C) Effect on earnings and profits.—The earnings and profits of any insurance company for its 1st taxable year beginning after December 31, 1986, shall be increased by the amount of the difference determined under subparagraph (A) with respect to such company.

SEC. 1022. TREATMENT OF CERTAIN DIVIDENDS AND TAX-EXEMPT INTEREST.

(a) In General.—Paragraph (5) of section 832(b) (defining losses incurred) is amended to read as follows:

"(5) Losses incurred.—

"(A) In general.—The term 'losses incurred' means losses incurred during the taxable year on insurance contracts, computed as follows:

"(i) To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year.

"(ii) To the result so obtained, add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year.

"(B) REDUCTION OF DEDUCTION.—The amount which would (but for this subparagraph) be taken into account under subparagraph (A) shall be reduced by an amount equal to 15 percent of the sum of—

"(i) tax-exempt interest received or accrued during such taxable year, and

"(ii) the aggregate amount of deductions provided by sections 243, 244, and 245 for—

"(I) dividends (other than 100 percent dividends) received during the taxable year, and

"(II) 100 percent dividends received during the taxable year to the extent attributable to prorated amounts.

In the case of a 100 percent dividend paid by an insurance company, the portion attributable to prorated amounts shall be determined under subparagraph (E)(ii).

"(C) EXCEPTION FOR INVESTMENTS MADE BEFORE AUGUST 8, 1986.—

"(i) IN GENERAL.—Except as provided in clause (ii), subparagraph (B) shall not apply to any dividend or interest received or accrued on any stock or obligation acquired before August 8, 1986.

"(ii) SPECIAL RULE FOR 100 PERCENT DIVIDENDS.—For purposes of clause (i), the portion of any 100 percent dividend which is attributable to prorated amounts shall be treated as received with respect to stock acquired on the later of—

"(I) the date the payor acquired the stock or obligation to which the prorated amounts are attributable, or

"(II) the 1st day on which the payor and payee were members of the same affiliated group (as defined in section 243(b)(5)).

"(D) DEFINITIONS.—For purposes of this paragraph—

"(i) PRORATED AMOUNTS.—The term 'prorated amounts' means tax-exempt interest and dividends with respect to which a deduction is allowable under section 243, 244, or 245 (other than 100 percent dividends).

"(ii) 100 PERCENT DIVIDEND.—

"(I) IN GENERAL.—The term '100 percent dividend' means any dividend if the percentage used for purposes of determining the deduction allowable under section 243, 244, or 245(b) is 100 percent.

"(II) CERTAIN DIVIDENDS RECEIVED BY FOREIGN CORPORATIONS.—A dividend received by a foreign corporation from a domestic corporation which would be a 100 percent dividend if section 1504(b)(3) did not apply for purposes of applying

section 243(b)(5) shall be treated as a 100 percent dividend.

"(E) Special rules for dividends subject to proration at subsidiary level.—

"(i) In general.—In the case of any 100 percent dividend paid to an insurance company to which this part applies by any insurance company, the amount of the decrease in the deductions of the payee company by reason of the portion of such dividend attributable to prorated amounts shall be reduced (but not below zero) by the amount of the decrease in the deductions (or increase in income) of the payor company attributable to the application of this section or section 805(a)(4)(A) to such amounts.

"(ii) Portion of dividend attributable to prorated amounts.—For purposes of this subparagraph, in determining the portion of any dividend attributable to prorated amounts—

"(I) any dividend by the paying corporation shall be treated as paid first out of earnings and profits attributable to prorated amounts (to the extent thereof), and

"(II) by determining the portion of earnings and profits so attributable without any reduction for the tax imposed by this chapter."

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1023. DISCOUNTING OF UNPAID LOSSES AND CERTAIN UNPAID EXPENSES.

(a) Limitation of Deduction in the Case of Property and Casualty Insurance Companies.—

(1) Losses incurred.—Clause (ii) of section 832(b)(5)(A) (defining losses incurred), as amended by section 1022, is amended to read as follows:

"(ii) To the result so obtained, add all unpaid losses on life insurance contracts plus all discounted unpaid losses (as defined in section 846) outstanding at the end of the taxable year and deduct unpaid losses on life insurance contracts plus all discounted unpaid losses outstanding at the end of the preceding taxable year."

(2) Expenses incurred.—Section 832(b)(6) (defining expenses incurred) is amended by inserting after the 1st sentence: "For purposes of this subchapter, the term 'expenses unpaid' shall not include any unpaid loss adjustment expenses shown on the annual statement, but such unpaid loss adjustment expenses shall be included in unpaid losses."

(b) Limitation of Deduction in the Case of Life Insurance Companies.—Section 807(c) (relating to reserves and similar items taken into account) is amended by adding at the end thereof the following new sentence: "For purposes of paragraph (2) and section 805(a)(1), the amount of the unpaid losses (other than losses on life insurance contracts) shall be the amount of the discounted unpaid losses as defined in section 846."

(c) Discounted Unpaid Losses Defined.—Part IV of subchapter L of chapter 1 (relating to provisions of general application) is amended by adding at the end thereof the following new section:

"SEC. 846. DISCOUNTED UNPAID LOSSES DEFINED.

"(a) Discounted Losses Determined.—

"(1) Separately computed for each accident year.—The amount of the discounted unpaid losses as of the end of any taxable year shall be the sum of the discounted unpaid losses (as of such time) separately computed under this section with respect to unpaid losses in each line of business attributable to each accident year.

"(2) Method of discounting.—The amount of the discounted unpaid losses as of the end of any taxable year attributable to any accident year shall be the present value of such losses (as of such time) determined by using—

"(A) the amount of the undiscounted unpaid losses as of such time,

"(B) the applicable interest rate, and

"(C) the applicable loss payment pattern.

"(3) Limitation on amount of discounted losses.—In no event shall the amount of the discounted unpaid losses with respect to any line of business attributable to any accident year exceed the aggregate amount of unpaid losses with respect to such line of business for such accident year included on the annual statement filed by the taxpayer for the year ending with or within the taxable year.

"(4) Determination of applicable factors.—In determining the amount of the discounted unpaid losses attributable to any accident year—

"(A) the applicable interest rate shall be the interest rate determined under subsection (c) for the calendar year with which such accident year ends, and

"(B) the applicable loss payment pattern shall be the loss payment pattern determined under subsection (d) which is in effect for the calendar year with which such accident year ends.

"(b) Determination of Undiscounted Unpaid Losses.—For purposes of this section—

"(1) In general.—Except as otherwise provided in this subsection, the term 'undiscounted unpaid losses' means the unpaid losses shown in the annual statement filed by the taxpayer for the year ending with or within the taxable year of the taxpayer.

"(2) Adjustment if losses discounted on annual statement.—If—

"(A) the amount of unpaid losses shown in the annual statement is determined on a discounted basis, and

"(B) the extent to which the losses were discounted can be determined on the basis of information disclosed on or with the annual statement,

the amount of the unpaid losses shall be determined without regard to any reduction attributable to such discounting.

"(c) Rate of Interest.—

"(1) In general.—For purposes of this section, the rate of interest determined under this subsection shall be the annual rate determined by the Secretary under paragraph (2).

"(2) Determination of annual rate.—

"(A) In general.—The annual rate determined by the Secretary under this paragraph for any calendar year shall be a rate equal to the average of the applicable Federal mid-term rates (as defined in section 1274(d) but based on annual compounding) effective as of the beginning of each of the calendar months in the test period.

"(B) Test period.—For purposes of subparagraph (A), the test period is the most recent 60-calendar-month period ending before the beginning of the calendar year for which the determination is made; except that there shall be excluded from the test period any month beginning before August 1, 1986.

"(d) Loss Payment Pattern.—

"(1) In general.—For each determination year, the Secretary shall determine a loss payment pattern for each line of business by reference to the historical loss payment pattern applicable to such line of business. Any loss payment pattern determined by the Secretary shall apply to the accident year ending with the determination year and to each of the 4 succeeding accident years.

"(2) Method of determination.—Determinations under paragraph (1) for any determination year shall be made by the Secretary—

"(A) by using the aggregate experience reported on the annual statements of insurance companies,

"(B) on the basis of the most recent published aggregate data from such annual statements relating to loss payment patterns available on the 1st day of the determination year,

"(C) as if all losses paid or treated as paid during any year are paid in the middle of such year, and

"(D) in accordance with the computational rules prescribed in paragraph (3).

"(3) Computational rules.—For purposes of this subsection—

"(A) In general.—Except as otherwise provided in this paragraph, the loss payment pattern for any line of business shall be based on the assumption that all losses are paid—

"(i) during the accident year and the 3 calendar years following the accident year, or

"(ii) in the case of any line of business reported in the schedule or schedules of the annual statement relating to auto liability, other liability, medical malpractice, workers' compensation, and multiple peril lines, during the accident year and the 10 calendar years following the accident year.

"(B) Treatment of certain losses.—Except as otherwise provided in this paragraph—

"(i) in the case of any line of business not described in subparagraph (A)(ii), losses paid after the 1st year

following the accident year shall be treated as paid equally in the 2nd and 3rd year following the accident year, and

"(ii) in the case of a line of business described in subparagraph (A)(ii), losses paid after the close of the period applicable under subparagraph (A)(ii) shall be treated as paid in the last year of such period.

"(C) SPECIAL RULE FOR CERTAIN LONG-TAIL LINES.—In the case of any long-tail line of business—

"(i) the period taken into account under subparagraph (A)(ii) shall be extended (but not by more than 5 years) to the extent required under clause (ii), and

"(ii) the amount of losses which would have been treated as paid in the 10th year after the accident year shall be treated as paid in such 10th year and each subsequent year in an amount equal to the amount of the losses treated as paid in the 9th year after the accident year (or, if lesser, the portion of the unpaid losses not theretofore taken into account).

Notwithstanding clause (ii), to the extent such unpaid losses have not been treated as paid before the last year of the extension, they shall be treated as paid in such last year.

"(D) LONG-TAIL LINE OF BUSINESS.—For purposes of subparagraph (C), the term 'long-tail line of business' means any line of business described in subparagraph (A)(ii) if the amount of losses which (without regard to subparagraph (C)) would be treated as paid in the 10th year after the accident year exceeds the losses treated as paid in the 9th year after the accident year.

"(E) SPECIAL RULE FOR INTERNATIONAL AND REINSURANCE LINES OF BUSINESS.—Except as otherwise provided by regulations, any determination made under subsection (a) with respect to unpaid losses relating to the international or reinsurance lines of business shall be made using, in lieu of the loss payment pattern applicable to the respective lines of business, a pattern determined by the Secretary under paragraphs (1) and (2) based on the combined losses for all lines of business described in subparagraph (A)(ii).

"(F) ADJUSTMENTS IF LOSS EXPERIENCE INFORMATION AVAILABLE FOR LONGER PERIODS.—The Secretary shall make appropriate adjustments in the application of this paragraph if annual statement data with respect to payment of losses is available for longer periods after the accident year than the periods assumed under the rules of this paragraph.

"(G) SPECIAL RULE FOR 9TH YEAR IF NEGATIVE OR ZERO.—If the amount of the losses treated as paid in the 9th year after the accident year is zero or a negative amount, subparagraphs (C)(ii) and (D) shall be applied by substituting the average of the losses treated as paid in the 7th, 8th, and 9th years after the accident year for the losses treated as paid in the 9th year after the accident year.

"(4) Determination year.—For purposes of this section, the term 'determination year' means calendar year 1987 and each 5th calendar year thereafter.

"(e) Election To Use Company's Historical Payment Pattern.—

"(1) In general.—The taxpayer may elect to apply subsection (a)(2)(C) with respect to all lines of business by using a loss payment pattern determined by reference to the taxpayer's loss payment pattern for the most recent calendar year for which an annual statement was filed before the beginning of the accident year. Any such determination shall be made with the application of the rules of paragraphs (2)(C) and (3) of subsection (d).

"(2) Election.—

"(A) In general.—An election under paragraph (1) shall be made separately with respect to each determination year under subsection (d).

"(B) Period for which election in effect.—Unless revoked with the consent of the Secretary, an election under paragraph (1) with respect to any determination year shall apply to accident years ending with the determination year and to each of the 4 succeeding accident years.

"(C) Time for making election.—An election under paragraph (1) with respect to any determination year shall be made on the taxpayer's return for the taxable year in which (or with which) the determination year ends.

"(3) No election for international or reinsurance business.—No election under this subsection shall apply to any international or reinsurance line of business.

"(4) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection including—

"(A) regulations providing that a taxpayer may not make an election under this subsection if such taxpayer does not have sufficient historical experience for the line of business to determine a loss payment pattern, and

"(B) regulations to prevent the avoidance (through the use of separate corporations or otherwise) of the requirement of this subsection that an election under this subsection applies to all lines of business of the taxpayer.

"(f) Other Definitions and Special Rules.—For purposes of this section—

"(1) Accident year.—The term 'accident year' means the calendar year in which the incident occurs which gives rise to the related unpaid loss.

"(2) Unpaid loss adjustment expenses.—The term 'unpaid losses' includes any unpaid loss adjustment expenses shown on the annual statement.

"(3) Annual statement.—The term 'annual statement' means the annual statement approved by the National Association of Insurance Commissioners which the taxpayer is required to file with insurance regulatory authorities of a State.

"(4) Line of business.—The term 'line of business' means a category for the reporting of loss payment patterns determined on the basis of the annual statement for fire and casualty in-

surance companies for the calendar year ending with or within the taxable year, except that the multiple peril lines shall be treated as a single line of business.

"(5) Multiple peril lines.—The term 'multiple peril lines' means the lines of business relating to farmowners multiple peril, homeowners multiple peril, commercial multiple peril, ocean marine, aircraft (all perils) and boiler and machinery.

"(6) Special rule for certain accident and health insurance lines of business.—Any determination under subsection (a) with respect to unpaid losses relating to accident and health insurance lines of businesses (other than credit disability insurance) shall be made—

"(A) in the case of unpaid losses relating to disability income, by using the general rules prescribed under section 807(d) applicable to noncancellable accident and health insurance contracts and using a mortality or morbidity table reflecting the taxpayer's experience; except that—

"(i) the prevailing State assumed interest rate shall be the rate in effect for the year in which the loss occurred rather than the year in which the contract was issued, and

"(ii) the limitation of subsection (a)(3) shall apply in lieu of the limitation of the last sentence of section 807(d)(1), and

"(B) in all other cases, by using an assumption (in lieu of a loss payment pattern) that unpaid losses are paid during the year following the accident year.

"(g) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including—

"(1) regulations providing proper treatment of allocated reinsurance, and

"(2) regulations providing proper treatment of salvage and reinsurance recoverable attributable to unpaid losses."

(d) Clerical Amendment.—The table of sections for such part IV is amended by adding at the end thereof the following new item:

"Sec. 846. Discounted unpaid losses defined."

(e) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Transitional rule.—For the first taxable year beginning after December 31, 1986—

(A) the unpaid losses and the expenses unpaid (as defined in paragraphs (5)(B) and (6) of section 832(b) of the Internal Revenue Code of 1986) at the end of the preceding taxable year, and

(B) the unpaid losses as defined in sections 807(c)(2) and 805(a)(1) of such Code at the end of the preceding taxable year,

shall be determined as if the amendments made by this section had applied to such unpaid losses and expenses unpaid in the preceding taxable year and by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 1987. For subsequent taxable years, such amendments

shall be applied with respect to such unpaid losses and expenses unpaid by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 1987.

(3) Fresh start.—

(A) In general.—Except as otherwise provided in this paragraph, any difference between—

(i) the amount determined to be the unpaid losses and expenses unpaid for the year preceding the 1st taxable year of an insurance company beginning after December 31, 1986, determined without regard to paragraph (2), and

(ii) such amount determined with regard to paragraph (2),

shall not be taken into account for purposes of the Internal Revenue Code of 1986.

(B) Reserve strengthening in years after 1985.—Subparagraph (A) shall not apply to any reserve strengthening in a taxable year beginning in 1986, and such strengthening shall be treated as occurring in the taxpayer's 1st taxable year beginning after December 31, 1986.

(C) Effect on earnings and profits.—The earnings and profits of any insurance company for its 1st taxable year beginning after December 31, 1986, shall be increased by the amount of the difference determined under subparagraph (A) with respect to such company.

SEC. 1024. REPEAL OF PROTECTION AGAINST LOSS ACCOUNT; REVISION OF SPECIAL TREATMENT FOR SMALL COMPANIES; COMBINATION OF PARTS II AND III.

(a) General Rule.—Subchapter L of chapter 1 is amended as follows:

(1) Part II (other than sections 822 and 826) is hereby repealed.

(2) Parts III and IV are hereby redesignated as parts II and III, respectively.

(3) Section 822 (relating to determination of taxable investment income) and section 826 (relating to election by reciprocal) are hereby redesignated as sections 834 and 835, respectively, and transferred to the end of part II (as redesignated by paragraph (2)).

(4) Section 831 is amended to read as follows:

"SEC. 831. TAX ON INSURANCE COMPANIES OTHER THAN LIFE INSURANCE COMPANIES.

"(a) General Rule.—Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company other than a life insurance company.

"(b) Alternative Tax for Certain Small Companies.—

"(1) In general.—In lieu of the tax otherwise applicable under subsection (a), there is hereby imposed for each taxable year on the income of every insurance company to which this subsection applies a tax computed by multiplying the taxable investment income of such company for such taxable year by the rates provided in section 11(b).

"(2) Companies to which this subsection applies.—

"(A) In general.—This subsection shall apply to every insurance company other than life (including interinsurers and reciprocal underwriters) if—

"(i) the net written premiums (or, if greater, direct written premiums) for the taxable year exceed $350,000 but do not exceed $1,200,000, and

"(ii) such company elects the application of this subsection for such taxable year.

"(B) Controlled group rules.—

"(i) In general.—For purposes of subparagraph (A), in determining whether any company is described in clause (i) of subparagraph (A), such company shall be treated as receiving during the taxable year amounts described in such clause (i) which are received during such year by all other companies which are members of the same controlled group as the insurance company for which the determination is being made.

"(ii) Controlled group.—For purposes of clause (i), the term 'controlled group' means any controlled group of corporations (as defined in section 1563(a)); except that—

"(I) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a), and

"(II) subsections (a)(4) and (b)(2)(D) of section 1563 shall not apply.

"(c) Cross References.—

"(1) For alternative tax in case of capital gains, see section 1201(a).

"(2) For taxation of foreign corporations carrying on an insurance business within the United States, see section 842.

"(3) For exemption from tax for certain insurance companies other than life, see section 501(c)(15)."

(b) Revision of Exemption From Tax.—Paragraph (15) of section 501(c) (relating to list of exempt organizations) is amended to read as follows:

"(15)(A) Insurance companies or associations other than life (including interinsurers and reciprocal underwriters) if the net written premiums (or, if greater, direct written premiums) for the taxable year do not exceed $350,000.

"(B) For purposes of subparagraph (A), in determining whether any company or association is described in subparagraph (A), such company or association shall be treated as receiving during the taxable year amounts described in subparagraph (A) which are received during such year by all other companies or associations which are members of the same controlled group as the insurance company or association for which the determination is being made.

"(C) For purposes of subparagraph (B), the term 'controlled group' has the meaning given such term by section 831(b)(2)(B)(ii)."

(c) Conforming Amendments.—

(1) Subparagraph (C) of section 832(b)(1) is amended by striking out "a mutual fire insurance company described in section

831(a)(3)(A)" and inserting in lieu thereof "a mutual fire insurance company exclusively issuing perpetual policies".

(2) Subparagraph (D) of section 832(b)(1) is amended to read as follows:

"(D) in the case of a mutual fire or flood insurance company whose principal business is the issuance of policies—

"(i) for which the premium deposits are the same (regardless of the length of the term for which the policies are written), and

"(ii) under which the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy,

an amount equal to 2 percent of the premiums earned on insurance contracts during the taxable year with respect to such policies after deduction of premium deposits returned or credited during the same taxable year, and".

(3) Paragraph (4) of section 832(b) is amended—

(A) by striking out "section 831(a)(3)(B)" each place it appears and inserting in lieu thereof "paragraph (1)(D)", and

(B) by striking out the last sentence and inserting in lieu thereof the following: "Premiums paid by the subscriber of a mutual flood insurance company described in paragraph (1)(D) or issuing exclusively perpetual policies shall be treated, for purposes of computing the taxable income of such subscriber, in the same manner as premiums paid by a policyholder to a mutual fire insurance company described in subparagraph (C) or (D) of paragraph (1)."

(4) Paragraph (5) of section 832(c) is amended by striking out "section 822(b)" and inserting in lieu thereof "section 834(b)".

(5) Paragraph (11) of section 832(c) is amended—

(A) by striking out "section 831(a)(3)(A)" and inserting in lieu thereof "subsection (b)(1)(C)", and

(B) by striking out "section 831(a)(3)(B)" and inserting in lieu thereof "subsection (b)(1)(D)".

(6) Section 832 is amended by adding at the end thereof the following new subsection:

"(f) INTERINSURERS.—In the case of a mutual insurance company which is an interinsurer or reciprocal underwriter—

"(1) there shall be allowed as a deduction the increase for the taxable year in savings credited to subscriber accounts, or

"(2) there shall be included as an item of gross income the decrease for the taxable year in savings credited to subscriber accounts.

For purposes of the preceding sentence, the term 'savings credited to subscriber accounts' means such portion of the surplus as is credited to the individual accounts of subscribers before the 16th day of the 3rd month following the close of the taxable year, but only if the company would be obligated to pay such amount promptly to such subscriber if he terminated his contract at the close of the company's taxable year. For purposes of determining his taxable income, the subscriber shall treat any such savings credited to his account as a dividend paid or declared."

(7) Subsection (a) of section 834 (as redesignated by subsection (a)) is amended to read as follows:

"(a) General Rule.—For purposes of section 831(b), the term 'taxable investment income' means the gross investment income, minus the deductions provided in subsection (c)."

(8) Subsection (d) of section 834 (as so redesignated) is amended—

(A) by striking out "section 821" each place it appears and inserting in lieu thereof "section 831", and

(B) by inserting before the period at the end of the last sentence of paragraph (2) the following:

"except in the case of discount which is original issue discount (as defined in section 1273)".

(9) Section 835 (as redesignated by subsection (a)) is amended—

(A) by striking out subsection (d) and by redesignating subsections (e), (f), (g), and (h) as subsections (d), (e), (f), and (g), respectively, and

(B) by amending subsection (e) (as so redesignated) to read as follows:

"(e) Benefits of Graduated Rates Denied.—Any increase in the taxable income of a reciprocal attributable to the limits provided in subsection (b) shall be taxed at the highest rate of tax specified in section 11(b)."

(10) Section 841 is amended—

(A) by striking out "section 801, 821, or 831" and inserting in lieu thereof "section 801 or 831",

(B) by inserting "and" at the end of paragraph (1),

(C) by striking out paragraph (2), and

(D) by redesignating paragraph (3) as paragraph (2).

(11) Section 842 is amended by striking out "part I, II, or III" and inserting in lieu thereof "part I or II".

(12) Section 844 is amended by striking out subsections (a) and (b) and inserting in lieu thereof the following:

"(a) General Rule.—If an insurance company—

"(1) is subject to the tax imposed by part I or II of this subchapter for the taxable year, and

"(2) was subject to the tax imposed by a different part of this subchapter for the taxable year,

then any operations loss carryover under section 810 (or the corresponding provisions of prior law) or net operating loss carryover under section 172 (as the case may be) arising in such prior taxable year shall be included in its operations loss deduction under section 810(a) or net operating loss deduction under section 832(c)(10), as the case may be.

"(b) Limitation.—The amount included under section 810(a) or 832(c)(10) (as the case may be) by reason of the application of subsection (a) shall not exceed the amount that would have constituted the loss carryover under such section if for all relevant taxable years the company had been subject to the tax imposed by the part referred to in subsection (a)(1) rather than the part referred to in subsection (a)(2). For purposes of applying the preceding sentence, section 810(b)(1)(C) (relating to additional years to which losses may be carried by new life insurance companies) shall not apply."

(13) Section 891 is amended by striking out "821,".

(14) Subsection (a) of section 1201 is amended by striking out "821(a) or (c) and 831(a)" and inserting in lieu thereof "831(a) or (b)".

(15) Paragraph (2) of section 1504(b) is amended by striking out "or 821".

(16) Paragraph (2)(A) of section 1504(c) is amended by striking out "or 821".

(17) Subparagraph (D) of section 1563(b)(2) is amended by striking out "or section 821".

(18) The table of sections for part II of subchapter L of chapter 1 (as redesignated by subsection (a)) is amended by adding at the end thereof the following new items:

"Sec. 834. Determination of taxable investment income.
"Sec. 835. Election by reciprocal."

(d) TRANSITIONAL RULES.—

(1) TREATMENT OF AMOUNTS IN PROTECTION AGAINST LOSS ACCOUNT.—In the case of any insurance company which had a protection against loss account for its last taxable year beginning before January 1, 1987, there shall be included in the gross income of such company for any taxable year beginning after December 31, 1986, the amount which would have been included in gross income for such taxable year under section 824 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act). For purposes of the preceding sentence, no addition to such account shall be made for any taxable year beginning after December 31, 1986.

(2) TRANSITIONAL RULE FOR UNUSED LOSS CARRYOVER UNDER SECTION 825.—Any unused loss carryover under section 825 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) which—

(A) is from a taxable year beginning before January 1, 1987, and

(B) could have been carried under such section to a taxable year beginning after December 31, 1986, but for the repeal made by subsection (a)(1),

shall be included in the net operating loss deduction under section 832(c)(10) of such Code without regard to the limitations of section 844(b) of such Code.

(e) EFFECTIVE DATE.—The amendments made by this section (and the provisions of subsection (d)) shall apply to taxable years beginning after December 31, 1986.

SEC. 1025. STUDY OF TREATMENT OF PROPERTY AND CASUALTY INSURANCE COMPANIES.

The Secretary of the Treasury or his delegate shall conduct a study of—

(1) the treatment of policyholder dividends by mutual property and casualty insurance companies,

(2) the treatment of property and casualty insurance companies under the minimum tax, and

(3) the operation and effect of, and revenue raised by, the amendments made by this subtitle.

Not later than January 1, 1989, such Secretary shall submit to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, and the Joint Committee on Taxation, the results of such study, together with such recommendations as he determines to be appropriate. The Secretary of the Treasury shall have authority to require the furnishing of such information as may be necessary to carry out the purposes of this section.

Subtitle D—Miscellaneous Provisions

SEC. 1031. PHYSICIANS' AND SURGEONS' MUTUAL PROTECTION AND INTERINDEMNITY ARRANGEMENTS OR ASSOCIATIONS.

(a) CERTAIN PHYSICIANS' AND SURGEONS' MUTUAL PROTECTION AND INTERINDEMNITY ARRANGEMENTS OR ASSOCIATIONS.—

(1) TREATMENT OF ARRANGEMENTS OR ASSOCIATIONS.—

(A) CAPITAL CONTRIBUTIONS.—There shall not be included in the gross income of any eligible physicians' and surgeons' mutual protection and interindemnity arrangement or association any initial payment made during any taxable year to such arrangement or association by a member joining such arrangement or association which—

(i) does not release such member from obligations to pay current or future dues, assessments, or premiums; and

(ii) is a condition precedent to receiving benefits of membership.

Such initial payment shall be included in the gross income of such arrangement or association for such taxable year if it is reasonable to expect that such payment will be deductible pursuant to paragraph (2) by any member of such arrangement or association.

(B) RETURN OF CONTRIBUTIONS.—

(i) IN GENERAL.—The repayment to any member of any amount of any payment excluded under subparagraph (A) shall not be treated as policyholder dividend, and is not deductible by the arrangement or association.

(ii) SOURCE OF RETURNS.—Except in the case of the termination of a member's interest in the arrangement or association, any amount distributed to any member shall be treated as paid out of surplus in excess of amounts excluded under subparagraph (A).

(2) DEDUCTION FOR MEMBERS OF ELIGIBLE ARRANGEMENTS OR ASSOCIATIONS.—

(A) PAYMENT AS TRADE OR BUSINESS EXPENSES.—To the extent not otherwise allowable under this title, any member of any eligible arrangement or association may treat any initial payment made during a taxable year to such arrangement or association as an ordinary and necessary expense incurred in connection with a trade or business for purposes of the deduction allowable under section 162, to the extent such payment does not exceed the amount which would be payable to an independent insurance company for

similar annual insurance coverage (as determined by the Secretary), and further reduced by any annual dues, assessments, or premiums paid during such taxable year. Such deduction shall not be allowable as to any initial payment made to an eligible arrangement or association by any person who is a member of any other eligible arrangement or association on or after the effective date of the Tax Reform Act of 1986. Any excess amount not allowed as a deduction for the taxable year in which such payment was made pursuant to the limitation contained in the 1st sentence of this subparagraph shall, subject to such limitation, be allowable as a deduction in any of the 5 succeeding taxable years, in order of time, to the extent not previously allowed as a deduction under this sentence.

(B) REFUNDS OF INITIAL PAYMENTS.—Any amount attributable to any initial payment to such arrangement or association described in paragraph (1) which is later refunded for any reason shall be included in the gross income of the recipient in the taxable year received, to the extent a deduction for such payment was allowed. Any amount refunded in excess of such payment shall be included in gross income except to the extent otherwise excluded from income by this title.

(3) ELIGIBLE ARRANGEMENTS OR ASSOCIATIONS.—The terms "eligible physicans' and surgeons' mutual protection and interindemnity arrangement or association" and "eligible arrangement or association" mean and are limited to any mutual protection and interindemnity arrangement or association that provides only medical malpractice liability protection for its members or medical malpractice liability protection in conjunction with protection against other liability claims incurred in the course of, or related to, the professional practice of a physician or surgeon and which—

(A) was operative and was providing such protection, or had received a permit for the offer and sale of memberships, under the laws of any State before January 1, 1984,

(B) is not subject to regulation by any State insurance department,

(C) has a right to make unlimited assessments against all members to cover current claims and losses, and

(D) is not a member of, nor subject to protection by, any insurance guaranty plan or association of any State.

(b) EFFECTIVE DATE.—The provisions of subsection (a) shall apply to payments made to and receipts of physicians' and surgeons' mutual protection and interindemnity arrangements or associations, and refunds of payments by such arrangements or associations, after the date of the enactment of this Act, in taxable years ending after such date.

TITLE XI—PENSIONS AND DEFERRED COMPENSATION; EMPLOYEE BENEFITS; EMPLOYEE STOCK OWNERSHIP PLANS

Subtitle A—Pensions and Deferred Compensation

PART I—LIMITATIONS ON TAX-DEFERRED SAVINGS

Subpart A—Rules Applicable to IRAs

SEC. 1101. LIMITATIONS ON IRA DEDUCTIONS FOR ACTIVE PARTICIPANTS IN CERTAIN PENSION PLANS.

(a) Limitations on Deductions for Active Participants.—

(1) In general.—Section 219 (relating to deduction for retirement savings) is amended by redesignating subsection (g) as subsection (h) and by adding after subsection (f) the following new subsection:

"(g) Limitation on Deduction for Active Participants in Certain Pension Plans.—

"(1) In general.—If (for any part of any plan year ending with or within a taxable year) an individual or the individual's spouse is an active participant, each of the dollar limitations contained in subsections (b)(1)(A) and (c)(2) for such taxable year shall be reduced (but not below zero) by the amount determined under paragraph (2).

"(2) Amount of reduction.—

"(A) In general.—The amount determined under this paragraph with respect to any dollar limitation shall be the amount which bears the same ratio to such limitation as—

"(i) the excess of—

"(I) the taxpayer's adjusted gross income for such taxable year, over

"(II) the applicable dollar amount, bears to

"(ii) $10,000.

"(B) No reduction below $200 until complete phase-out.—No dollar limitation shall be reduced below $200 under paragraph (1) unless (without regard to this subparagraph) such limitation is reduced to zero.

"(C) Rounding.—Any amount determined under this paragraph which is not a multiple of $10 shall be rounded to the next lowest $10.

"(3) Adjusted gross income; applicable dollar amount.—For purposes of this subsection—

"(A) Adjusted gross income.—Adjusted gross income of any taxpayer shall be determined—

"(i) after application of sections 86 and 469, and

"(ii) without regard to section 911 or the deduction allowable under this section.

"(B) Applicable dollar amount.—The term 'applicable dollar amount' means—

"(i) in the case of a taxpayer filing a joint return, $40,000,

"(ii) in the case of any other taxpayer (other than a married individual filing a separate return), $25,000, and

"(iii) in the case of a married individual filing a separate return, zero.

"(4) SPECIAL RULE FOR MARRIED INDIVIDUALS FILING SEPARATELY.—In the case of a married individual filing a separate return for any taxable year, paragraph (1) shall be applied without regard to whether such individual's spouse is an active participant for any plan year ending with or within such taxable year.

"(5) ACTIVE PARTICIPANT.—For purposes of this subsection, the term 'active participant' means, with respect to any plan year, an individual—

"(A) who is an active participant in—

"(i) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(ii) an annuity plan described in section 403(a),

"(iii) a plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing,

"(iv) an annuity contract described in section 403(b), or

"(v) a simplified employee pension (within the meaning of section 408(k)), or

"(B) who makes deductible contributions to a trust described in section 501(c)(18).

The determination of whether an individual is an active participant shall be made without regard to whether or not such individual's rights under a plan, trust, or contract are nonforfeitable. An eligible deferred compensation plan (within the meaning of section 457(b)) shall not be treated as a plan described in subparagraph (A)(iii).

"(6) CERTAIN INDIVIDUALS NOT TREATED AS ACTIVE PARTICIPANTS.—For purposes of this subsection, any individual described in any of the following subparagraphs shall not be treated as an active participant for any taxable year solely because of any participation so described:

"(A) MEMBERS OF RESERVE COMPONENTS.—Participation in a plan described in subparagraph (A)(iii) of paragraph (5) by reason of service as a member of a reserve component of the Armed Forces (as defined in section 261(a) of title 10), unless such individual has served in excess of 90 days on active duty (other than active duty for training) during the year.

"(B) VOLUNTEER FIREFIGHTERS.—A volunteer firefighter—

"(i) who is a participant in a plan described in subparagraph (A)(iii) of paragraph (5) based on his activity as a volunteer firefighter, and

"(ii) whose accrued benefit as of the beginning of the taxable year is not more than an annual benefit of $1,800 (when expressed as a single life annuity commencing at age 65)."

(2) CONFORMING AMENDMENT.—Section 219(f)(3) is amended to read as follows:

"(3) TIME WHEN CONTRIBUTIONS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a contribution to an individual retirement plan on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof)."

(b) REPEAL OF DEDUCTION FOR QUALIFIED VOLUNTARY EMPLOYEE CONTRIBUTIONS.—

(1) IN GENERAL.—Subsection (e) of section 219 (relating to defining retirement savings contributions) is amended to read as follows:

"(e) QUALIFIED RETIREMENT CONTRIBUTION.—For purposes of this section, the term 'qualified retirement contribution' means—

"(1) any amount paid in cash for the taxable year by or on behalf of an individual to an individual retirement plan for such individual's benefit, and

"(2) any amount contributed on behalf of any individual to a plan described in section 501(c)(18)."

(2) CONFORMING AMENDMENTS.—

(A) Section 219(b) is amended by striking out paragraph (3).

(B) Paragraph (3) of section 72(p) is amended to read as follows:

"(3) QUALIFIED EMPLOYER PLAN, ETC.—For purposes of this subsection—

"(A) QUALIFIED EMPLOYER PLAN.—

"(i) IN GENERAL.—The term 'qualified employer plan' means—

"(I) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(II) an annuity plan described in section 403(a), and

"(III) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

"(ii) SPECIAL RULES.—The term 'qualified employer plan'—

"(I) shall include any plan which was (or was determined to be) a qualified employer plan or a government plan, but

"(II) shall not include a plan described in subsection (e)(7).

"(B) GOVERNMENT PLAN.—The term 'government plan' means any plan, whether or not qualified, established and maintained for its employees by the United States, by a

State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing."

(C) Paragraph (5) of section 72(o) is amended—

(i) by inserting "and made for a taxable year beginning before January 1, 1987," after "date" in subparagraph (A),

(ii) by striking out "section 219(e)(3)" in subparagraph (C) and inserting in lieu thereof "subsection (p)(3)(A)(i)", and

(iii) by striking out "section 219(e)(4)" in subparagraph (D) and inserting in lieu thereof "subsection (p)(3)(B)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contributions for taxable years beginning after December 31, 1986.

SEC. 1102. NONDEDUCTIBLE CONTRIBUTIONS MAY BE MADE TO INDIVIDUAL RETIREMENT PLANS.

(a) IN GENERAL.—Section 408 (relating to individual retirement accounts) is amended by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) the following new subsection:

"(o) DEFINITIONS AND RULES RELATING TO NONDEDUCTIBLE CONTRIBUTIONS TO INDIVIDUAL RETIREMENT PLANS.—

"(1) IN GENERAL.—Subject to the provisions of this subsection, designated nondeductible contributions may be made on behalf of an individual to an individual retirement plan.

"(2) LIMITS ON AMOUNTS WHICH MAY BE CONTRIBUTED.—

"(A) IN GENERAL.—The amount of the designated nondeductible contributions made on behalf of any individual for any taxable year shall not exceed the nondeductible limit for such taxable year.

"(B) NONDEDUCTIBLE LIMIT.—For purposes of this paragraph—

"(i) IN GENERAL.—The term 'nondeductible limit' means the excess of—

"(I) the amount allowable as a deduction under section 219 (determined without regard to section 219(g)), over

"(II) the amount allowable as a deduction under section 219 (determined with regard to section 219(g)).

"(ii) TAXPAYER MAY ELECT TO TREAT DEDUCTIBLE CONTRIBUTIONS AS NONDEDUCTIBLE.—If a taxpayer elects not to deduct an amount which (without regard to this clause) is allowable as a deduction under section 219 for any taxable year, the nondeductible limit for such taxable year shall be increased by such amount.

"(C) DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.—

"(i) IN GENERAL.—For purposes of this paragraph, the term 'designated nondeductible contribution' means any contribution to an individual retirement plan for the taxable year which is designated (in such manner

as the Secretary may prescribe) as a contribution for which a deduction is not allowable under section 219.

"(ii) Designation.—Any designation under clause (i) shall be made on the return of tax imposed by chapter 1 for the taxable year.

"(3) Time when contributions made.—In determining for which taxable year a designated nondeductible contribution is made, the rule of section 219(f)(3) shall apply.

"(4) Individual required to report amount of designated nondeductible contributions.—

"(A) In general.—Any individual who—

"(i) makes a designated nondeductible contribution to any individual retirement plan for any taxable year, or

"(ii) receives any amount from any individual retirement plan for any taxable year,

shall include on his return of the tax imposed by chapter 1 for such taxable year and any succeeding taxable year (or on such other form as the Secretary may prescribe for any such taxable year) information described in subparagraph (B).

"(B) Information required to be supplied.—The following information is described in this subparagraph:

"(i) The amount of designated nondeductible contributions for the taxable year.

"(ii) The amount of distributions from individual retirement plans for the taxable year.

"(iii) The excess (if any) of—

"(I) the aggregate amount of designated nondeductible contributions for all preceding taxable years, over

"(II) the aggregate amount of distributions from individual retirement plans which was excludable from gross income for such taxable years.

"(iv) The aggregate balance of all individual retirement plans of the individual as of the close of the calendar year with or within which the taxable year ends.

"(v) Such other information as the Secretary may prescribe.

"(C) Penalty for reporting contributions not made.—

"For penalty where individual reports designated nondeductible contributions not made, see section 6693(b)."

(b) Excess Contributions.—

(1) Application of tax.—Section 4973(b) (defining excess contributions) is amended by adding at the end thereof the following new sentence: "For purposes of paragraphs (1)(B) and (2)(C), the amount allowable as a deduction under section 219 (after application of section 408(o)(2)(B)(ii)) shall be increased by the nondeductible limit under section 408(o)(2)(B).

(2) Return of excess contributions.—Paragraph (5) of section 408(d) (relating to tax treatment of distributions) is amended by adding at the end thereof the following new sentence: For purposes of this paragraph, the amount allowable as a deduc-

tion under section 219 (after application of section 408(o)(2)(B)(ii)) shall be increased by the nondeductible limit under section 408(o)(2)(B)."

(c) TREATMENT OF DISTRIBUTIONS.—Paragraphs (1) and (2) of section 408(d) (relating to tax treatment of distributions) are amended to read as follows:

"(1) IN GENERAL.—Except as otherwise provided in this subsection, any amount paid or distributed out of an individual retirement plan shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

"(2) SPECIAL RULES FOR APPLYING SECTION 72.—For purposes of applying section 72 to any amount described in paragraph (1)—

"(A) all individual retirement plans shall be treated as 1 contract,

"(B) all distributions during any taxable year shall be treated as 1 distribution, and

"(C) the value of the contract, income on the contract, and investment in the contract shall be computed as of the close of the calendar year with or within which the taxable year ends.

For purposes of subparagraph (C), the value of the contract shall be increased by the amount of any distributions during the calendar year."

(d) PENALTY FOR REPORTING NONDEDUCTIBLE CONTRIBUTIONS NOT MADE.—

(1) IN GENERAL.—Section 6693 (relating to failure to provide reports on individual retirement accounts or annuities) is amended by redesignating subsection (b) as subsection (c) and by inserting after subsection (a) the following new subsection:

"(b) OVERSTATEMENT OF DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS.—Any individual who—

"(1) is required to furnish information under section 408(o)(4) as to the amount of designated nondeductible contributions made for any taxable year, and

"(2) overstates the amount of such contributions made for such taxable year,

shall pay a penalty of $100 for each such overstatement unless it is shown that such overstatement is due to reasonable cause."

(2) CONFORMING AMENDMENTS.—

(A) Section 6693(c), as redesignated by paragraph (1), is amended by striking out "subsection (a)" and inserting in lieu thereof "this section".

*(B) The heading for section 6693 is amended by inserting "; **OVERSTATEMENT OF DESIGNATED NONDEDUCTIBLE CONTRIBUTIONS**" after "**ANNUITIES**".*

(C) The item relating to section 6693 in the table of sections for subchapter B of chapter 68 is amended by inserting "; overstatement of designated nondeductible contributions" after "annuities".

(e) SPECIAL RULES RELATING TO REQUIREMENTS OF TRUSTEES OF INDIVIDUAL RETIREMENT PLANS.—

(1) Withholding.—Subparagraph (B) of section 3405(d)(1) (relating to exceptions) is amended by adding at the end thereof the following new flush sentence:

"For purposes of clause (ii), any distribution or payment from or under an individual retirement plan shall be treated as includible in gross income."

(2) Time for reporting information with respect to individual retirement plans.—The last sentence of section 408(i) (relating to reports) is amended to read as follows: "The reports required by this subsection—

"(1) shall be filed at such time and in such manner as the Secretary prescribes in such regulations, and

"(2) shall be furnished to individuals—

"(A) not later than January 31 of the calendar year following the calendar year to which such reports relate, and

"(B) in such manner as the Secretary prescribes in such regulations."

(f) Conforming Amendment.—Section 219(f) (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(7) Election not to deduct contributions.—

"For election not to deduct contributions to individual retirement plans, see section 408(o)(2)(B)(ii)."

(g) Effective Date.—The amendments made by this section shall apply to contributions and distributions for taxable years beginning after December 31, 1986.

SEC. 1103. SPOUSAL DEDUCTION ALLOWED WHERE SPOUSE HAS SMALL AMOUNT OF EARNED INCOME.

(a) In General.—Subparagraph (B) of section 219(c)(1) (relating to special rules for certain married individuals) is amended to read as follows:

"(B) whose spouse—

"(i) has no compensation (determined without regard to section 911) for the taxable year, or

"(ii) elects to be treated for purposes of subsection (b)(1)(B) as having no compensation for the taxable year,"

(b) Effective Date.—The amendment made by this section shall apply to taxable years beginning before, on, or after December 31, 1985.

Subpart B—Other Provisions

SEC. 1105. $7,000 LIMITATION ON ELECTIVE DEFERRALS.

(a) General Rule.—Section 402 (relating to taxability of beneficiary of employees' trust) is amended by adding at the end thereof the following new subsection:

"(g) Limitation on Exclusion for Elective Deferrals.—

"(1) In general.—Notwithstanding subsections (a)(8) and (h)(1)(B), the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds $7,000.

"(2) Required distribution of excess deferrals.—

"(A) In general.—If any amount (hereinafter in this paragraph referred to as 'excess deferrals') is included in the gross income of an individual under paragraph (1) for any taxable year—

"(i) not later than the 1st March 1 following the close of the taxable year, the individual may allocate the amount of such excess deferrals among the plans under which the deferrals were made and may notify each such plan of the portion allocated to it, and

"(ii) not later than the 1st April 15 following the close of the taxable year, each such plan may distribute to the individual the amount allocated to it under clause (i) (and any income allocable to such amount).

The distribution described in clause (ii) may be made notwithstanding any other provision of law.

"(B) Treatment of distribution under section 401(k).—Except to the extent provided under rules prescribed by the Secretary, notwithstanding the distribution of any portion of an excess deferral from a plan under subparagraph (A)(ii), such portion shall, for purposes of applying section 401(k)(3)(A)(ii), be treated as an employer contribution.

"(C) Taxation of distribution.—In the case of a distribution to which subparagraph (A) applies—

"(i) except as provided in clause (ii), such distribution shall not be included in gross income (and no tax shall be imposed under section 72(t)), and

"(ii) any income on the excess deferral shall, for purposes of this chapter, be treated as earned and received in the taxable year in which such excess deferral is made.

"(3) Elective deferrals.—For purposes of this paragraph, the term 'elective deferrals' means, with respect to any taxable year, the sum of—

"(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not includible in gross income for the taxable year under subsection (a)(8) (determined without regard to this subsection),

"(B) any employer contribution to the extent not includible in gross income for the taxable year under subsection (h)(1)(B) (determined without regard to this subsection), and

"(C) any employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement (within the meaning of section 3121(a)(5)(D)).

"(4) Increase in limit for amounts contributed under section 403(b) contracts.—The limitation under paragraph (1) shall be increased (but not to an amount in excess of $9,500) by the amount of any employer contributions for the taxable year described in paragraph (3)(C).

"(5) Cost-of-living adjustment.—The Secretary shall adjust the $7,000 amount under paragraph (1) at the same time and in the same manner as under section 415(d).

"(6) Disregard of community property laws.—This subsection shall be applied without regard to community property laws.

"(7) Coordination with section 72.—For purposes of applying section 72, any amount includible in gross income for any taxable year under this subsection but which is not distributed from the plan during such taxable year shall not be treated as investment in the contract.

"(8) Special rule for certain organizations.—

"(A) In general.—In the case of a qualified employee of a qualified organization, with respect to employer contributions described in paragraph (3)(C) made by such organization, the limitation of paragraph (1) for any taxable year shall be increased by whichever of the following is the least:

"(i) $3,000,

"(ii) $15,000 reduced by amounts not included in gross income for prior taxable years by reason of this paragraph, or

"(iii) the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the employer contributions described in paragraph (3) made by the organization on behalf of such employee for prior taxable years.

"(B) Qualified organization.—For purposes of this paragraph, the term 'qualified organization' means any educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches. Such term includes any organization described in section 414(e)(3)(B)(ii). Terms used in this subparagraph shall have the same meaning as when used in section 415(c)(4).

"(C) Qualified employee.—For purposes of this paragraph, the term 'qualified employee' means any employee who has completed 15 years of service with the qualified organization."

(b) Reporting Requirements.—Section 6051(a) (relating to requirements of receipts for employees) is amended by striking "and" at the end of paragraph (6), by striking the period at the end of paragraph (7), and by inserting after paragraph (7) the following new paragraph:

"(8) the total amount of elective deferrals (within the meaning of section 402(g)(3)) and compensation deferred under section 457."

(c) Effective Dates.—

(1) In general.—Except as provided in this subsection, the amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

(2) Deferrals under collective bargaining agreements.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendment made by subsection (a) shall not apply to

contributions made pursuant to such an agreement for taxable years beginning before the earlier of—

(A) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1989.

Such contributions shall be taken into account for purposes of applying the amendment made by this section to other plans.

(3) DISTRIBUTIONS MADE BEFORE PLAN AMENDMENT.—

(A) IN GENERAL.—If a plan amendment is required to allow the plan to make any distribution described in section 402(g)(2)(A)(ii) of the Internal Revenue Code of 1986, any such distribution which is made before the close of the 1st plan year for which such amendment is required to be in effect under section 1140 shall be treated as made in accordance with the provisions of such plan.

(B) DISTRIBUTIONS PURSUANT TO MODEL AMENDMENT.—

(i) SECRETARY TO PRESCRIBE AMENDMENT.—The Secretary of the Treasury or his delegate shall prescribe an amendment which allows a plan to make any distribution described in section 402(g)(2)(A)(ii) of such Code.

(ii) ADOPTION BY PLAN.—If a plan adopts the amendment prescribed under clause (i) and makes a distribution in accordance with such amendment, such distribution shall be treated as made in accordance with the provisions of the plan.

(4) SPECIAL RULE FOR TAXABLE YEARS OF PARTNERSHIPS WHICH INCLUDE JANUARY 1, 1987.—In the case of the taxable year of any partnership which begins before January 1, 1987, and ends after January 1, 1987, elective deferrals (within the meaning of section 402(g)(3) of the Internal Revenue Code of 1986) made on behalf of a partner for such taxable year shall, for purposes of section 402(g)(3) of such Code, be treated as having been made ratably during such taxable year.

(5) CASH OR DEFERRED ARRANGEMENTS.—The amendments made by this section shall not apply to employer contributions made during 1987 and attributable to services performed during 1986 under a qualified cash or deferred arrangement (as defined in section 401(k) of the Internal Revenue Code of 1986) if, under the terms of such arrangement as in effect on August 16, 1986—

(A) the employee makes an election with respect to such contribution before January 1, 1987, and

(B) the employer identifies the amount of such contribution before January 1, 1987.

SEC. 1106. ADJUSTMENTS TO LIMITATIONS ON CONTRIBUTIONS AND BENEFITS UNDER QUALIFIED PLANS.

(a) ADJUSTMENT OF ANNUAL CONTRIBUTION LIMITS.—Subparagraph (A) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended to read as follows:

"(A) $30,000 (or, if greater, ¼ of the dollar limitation in effect under subsection (b)(1)(A)), or".

(b) ADJUSTMENT OF DEFINED BENEFIT PLAN LIMITS.—

(1) USE OF SOCIAL SECURITY RETIREMENT AGE.—

(A) IN GENERAL.—Subparagraphs (C) and (D) of section 415(b)(2) are each amended—

(i) by striking out "age 62" and "age 65" each place they appear and inserting in lieu thereof "the social security retirement age", and

(ii) by striking out the last sentence of subparagraph (C) and inserting in lieu thereof the following: "The reduction under this subparagraph shall be made in such manner as the Secretary may prescribe which is consistent with the reduction for old-age insurance benefits commencing before the social security retirement age under the Social Security Act."

(B) DEFINITION OF SOCIAL SECURITY RETIREMENT AGE.—Section 415(b) is amended by adding at the end thereof the following new paragraph:

"(8) SOCIAL SECURITY RETIREMENT AGE DEFINED.—For purposes of this subsection, the term 'social security retirement age' means the age used as the retirement age under section 216(l) of the Social Security Act, except that such section shall be applied—

"(A) without regard to the age increase factor, and

"(B) as if the early retirement age under section 216(l)(2) of such Act were 62."

(2) SPECIAL RULES FOR GOVERNMENTAL AND TAX-EXEMPT PLANS AND QUALIFIED POLICE AND FIREFIGHTERS.—Paragraph (2) of section 415(b) (relating to annual benefit) is amended by adding at the end thereof the following new subparagraphs:

"(F) PLANS MAINTAINED BY GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—In the case of a governmental plan (within the meaning of section 414(d)), a plan maintained by an organization (other than a governmental unit) exempt from tax under this subtitle, or a qualified merchant marine plan—

"(i) subparagraph (C) shall be applied—

"(I) by substituting 'age 62' for 'social security retirement age' each place it appears, and

"(II) as if the last sentence thereof read as follows: 'The reduction under this subparagraph shall not reduce the limitation of paragraph (1)(A) below (i) $75,000 if the benefit begins at or after age 55, or (ii) if the benefit begins before age 55, the equivalent of the $75,000 limitation for age 55.', and

"(ii) subparagraph (D) shall be applied by substituting 'age 65' for 'social security retirement age' each place it appears.

For purposes of this subparagraph, the term 'qualified merchant marine plan' means a plan in existence on January 1, 1986, the participants in which are merchant marine officers holding licenses issued by the Secretary of Transportation under title 46, United States Code.

"(G) SPECIAL LIMITATION FOR QUALIFIED POLICE OR FIREFIGHTERS.—In the case of a qualified participant—

"(i) subparagraph (C) shall not reduce the limitation of paragraph (1)(A) to an amount less than $50,000, and

"(ii) the rules of subparagraph (F) shall apply.

The Secretary shall adjust the $50,000 amount in clause (i) at the same time and in the same manner as under section 415(d).

"(H) QUALIFIED PARTICIPANT DEFINED.—For purposes of subparagraph (G), the term 'qualified participant' means a participant—

"(i) in a defined benefit plan which is maintained by a State or political subdivision thereof,

"(ii) with respect to whom the period of service taken into account in determining the amount of the benefit under such defined benefit plan includes at least 20 years of service of the participant—

"(I) as a full-time employee of any police department or fire department which is organized and operated by the State or political subdivision maintaining such defined benefit plan to provide police protection, firefighting services, or emergency medical services for any area within the jurisdiction of such State or political subdivision, or

"(II) as a member of the Armed Forces of the United States."

(3) TREATMENT OF AIRLINE PILOTS.—Subsection (b) of section 415 (relating to limitation for defined benefit plans) is amended by adding at the end thereof the following new paragraph:

"(9) SPECIAL RULE FOR COMMERCIAL AIRLINE PILOTS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of any participant who is a commercial airline pilot—

"(i) the rule of paragraph (2)(F)(i)(II) shall apply, and

"(ii) if, as of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before the social security retirement age, paragraph (2)(C) (after application of clause (i)) shall be applied by substituting such age for the social security retirement age.

"(B) INDIVIDUALS WHO SEPARATE FROM SERVICE BEFORE AGE 60.—If a participant described in subparagraph (A) separates from service before age 60, the rules of paragraph (2)(F) shall apply."

(4) SPECIAL ELECTIONS FOR SECTION 403(b) CONTRACTS.—Subparagraphs (A), (B), and (C) of section 415(c)(4) are each amended by inserting "a health and welfare service agency," after "a home health service agency,".

(c) CONTRIBUTIONS TO COST-OF-LIVING ARRANGEMENTS UNDER DEFINED BENEFIT PLANS.—

(1) IN GENERAL.—Section 415(k) (relating to special rules for limitations on benefits and contributions under qualified plans)

is amended by adding at the end thereof the following new paragraph:

"(2) CONTRIBUTIONS TO PROVIDE COST-OF-LIVING PROTECTION UNDER DEFINED BENEFIT PLANS.—

"(A) IN GENERAL.—In the case of a defined benefit plan which maintains a qualified cost-of-living arrangement—

"(i) any contribution made directly by an employee under such arrangement—

"(I) shall not be treated as an annual addition for purposes of subsection (c), but

"(II) shall be so treated for purposes of subsection (e), and

"(ii) any benefit under such arrangement which is allocable to an employer contribution which was transferred from a defined contribution plan and to which the requirements of subsection (c) were applied shall, for purposes of subsection (b), be treated as a benefit derived from an employee contribution (and subsections (c) and (e) shall not again apply to such contribution by reason of such transfer).

"(B) QUALIFIED COST-OF-LIVING ARRANGEMENT DEFINED.—For purposes of this paragraph, the term 'qualified cost-of-living arrangement' means an arrangement under a defined benefit plan which—

"(i) provides a cost-of-living adjustment to a benefit provided under such plan or a separate plan subject to the requirements of section 412, and

"(ii) meets the requirements of subparagraphs (C), (D), (E), and (F) and such other requirements as the Secretary may prescribe.

"(C) DETERMINATION OF AMOUNT OF BENEFIT.—An arrangement meets the requirement of this subparagraph only if the cost-of-living adjustment of participants is based—

"(i) on increases in the cost-of-living after the annuity starting date, and

"(ii) on average cost-of-living increases determined by reference to 1 or more indexes prescribed by the Secretary, except that the arrangement may provide that the increase for any year will not be less than 3 percent of the retirement benefit (determined without regard to the arrangement).

"(D) ARRANGEMENT ELECTIVE; TIME FOR ELECTION.—An arrangement meets the requirements of this subparagraph only if it is elective, it is available under the same terms to all participants, and it provides that such election may be made in—

"(i) the year in which the participant—

"(I) attains the earliest retirement age under the defined benefit plan (determined without regard to any requirement of separation from service), or

"(II) separates from service, or

"(ii) both such years.

"(E) NONDISCRIMINATION REQUIREMENTS.—An arrangement shall not meet the requirements of this subparagraph

if the Secretary finds that a pattern of discrimination exists with respect to participation.

"(F) Special rules for key employees.—

"(i) In general.—An arrangement shall not meet the requirements of this paragraph if any key employee is eligible to participate.

"(ii) Key employee.—For purposes of this subparagraph, the term 'key employee' has the meaning given such term by section 416(i)(1), except that in the case of a plan other than a top-heavy plan (within the meaning of section 416(g)), such term shall not include an individual who is a key employee solely by reason of section 416(i)(1)(A)(i)."

(2) Certain transfers to defined benefit plans not taken into account for purposes of lump sum distribution.—Section 402(e)(4) (relating to special rules for lump sum distributions) is amended by adding at the end thereof the following new subparagraph:

"(N) Transfers to cost-of-living arrangement not treated as distribution.—For purposes of this subsection, the balance to the credit of an employee under a defined contribution plan shall not include any amount transferred from such defined contribution plan to a qualified cost-of-living arrangement (within the meaning of section 415(k)(2)) under a defined benefit plan."

(d) Limitation on Amount of Annual Compensation Which May Be Taken Into Account.—

(1) In general.—Subsection (a) of section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by inserting after paragraph (16) the following new paragraph:

"(17) A trust shall not constitute a qualified trust under this section unless, under the plan of which such trust is a part, the annual compensation of each employee taken into account under the plan for any year does not exceed $200,000. The Secretary shall adjust the $200,000 amount at the same time and in the same manner as under section 415(d)."

(2) Deduction for employer contributions.—Section 404 (relating to deduction for contributions of employers to plans) is amended by adding at the end thereof the following new subsection:

"(l) Limitation on Amount of Annual Compensation Taken Into Account.—For purposes of applying the limitations of this section, the amount of annual compensation of each employee taken into account under the plan for any year shall not exceed $200,000. The Secretary shall adjust the $200,000 amount at the same time and in the same manner as under section 415(d)."

(3) Conforming amendments.—

(A) Subsection (a) of section 416 is amended by inserting "and" at the end of paragraph (1), by striking out ", and" at the end of paragraph (2) and inserting in lieu thereof a period, and by striking out paragraph (3).

(B)(i) Subsection (d) of section 416 is hereby repealed.

(ii) Section 416(c)(2)(B) is amended by striking out clause (ii) and by redesignating clause (iii) as clause (ii).

(C) Paragraph (3) of section 818(a) is amended by inserting "(17)," after "(16),".

(e) TREATMENT OF EMPLOYEE CONTRIBUTIONS FOR PURPOSES OF DETERMINING ANNUAL ADDITION.—

(1) IN GENERAL.—Subparagraph (B) of section 415(c)(2) (defining annual addition) is amended to read as follows:

"(B) the employee contributions, and".

(2) ANNUAL COMPENSATION LIMIT NOT TO APPLY TO CONTRIBUTIONS FOR POST-RETIREMENT MEDICAL BENEFITS.—Section 415(c)(2) is amended by adding at the end thereof the following new sentence: "Subparagraph (B) of paragraph (1) shall not apply to any contribution for medical benefits (within the meaning of section 419A(f)(2)) after separation from service which is treated as an annual addition."

(f) PHASE-IN OF LIMITATION FOR DEFINED BENEFIT PLANS BASED ON YEARS OF PARTICIPATION.—Paragraph (5) of section 415(b) (relating to reduction for service less than 10 years) is amended to read as follows:

"(5) REDUCTION FOR PARTICIPATION OR SERVICE OF LESS THAN 10 YEARS.—

"(A) DOLLAR LIMITATION.—In the case of an employee who has less than 10 years of participation in a defined benefit plan, the limitation referred to in paragraph (1)(A) shall be the limitation determined under such paragraph (without regard to this paragraph) multiplied by a fraction—

"(i) the numerator of which is the number of years (or part thereof) of participation in the defined benefit plan of the employer, and

"(ii) the denominator of which is 10.

"(B) COMPENSATION AND BENEFITS LIMITATIONS.—The provisions of subparagraph (A) shall apply to the limitations under paragraphs (1)(B) and (4), except that such subparagraph shall be applied with respect to years of service with an employer rather than years of participation in a plan.

"(C) LIMITATION ON REDUCTION.—In no event shall subparagraph (A) or (B) reduce the limitations referred to in paragraphs (1) and (4) to an amount less than $^1/_{10}$ of such limitation (determined without regard to this paragraph).

"(D) APPLICATION TO CHANGES IN BENEFIT STRUCTURE.—To the extent provided in regulations, this paragraph shall be applied separately with respect to each change in the benefit structure of a plan."

(g) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 415(d) is amended by inserting "and" at the end of subparagraph (A), by striking out subparagraph (B), and by redesignating subparagraph (C) as paragraph (B).

(2) Paragraph (2) of section 415(d) is amended—

(A) by striking out "subparagraphs (A) and (B)" and inserting in lieu thereof "subparagraph (A)", and

(B) by striking out "subparagraph (C)" and inserting in lieu thereof "subparagraph (B)".

(3) Paragraph (3) of section 415(d) is amended by striking out "subparagraph (A) or (B)" and inserting in lieu thereof "subparagraph (A)".

(h) PLANS MAY INCORPORATE SECTION 415 LIMITATIONS BY REFERENCE.—Notwithstanding any other provision of law, except as provided in regulations prescribed by the Secretary of the Treasury or his delegate, a plan may incorporate by reference the limitations under section 415 of the Internal Revenue Code of 1986.

(i) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to years beginning after December 31, 1986.

(2) COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section (other than subsection (d)) shall not apply to contributions or benefits pursuant to such agreement in years beginning before the earlier of—

(A) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1989.

(3) RIGHT TO HIGHER ACCRUED DEFINED BENEFIT PRESERVED.—

(A) IN GENERAL.—In the case of an individual who is a participant (as of the 1st day of the 1st year to which the amendments made by this section apply) in a defined benefit plan which is in existence on May 6, 1986, and with respect to which the requirements of section 415 of the Internal Revenue Code of 1986 have been met for all plan years, if such individual's current accrued benefit under the plan exceeds the limitation of subsection (b) of section 415 of such Code (as amended by this section), then (in the case of such plan), for purposes of subsections (b) and (e) of such section, the limitation of such subsection (b)(1)(A) with respect to such individual shall be equal to such current accrued benefit.

(B) CURRENT ACCRUED BENEFIT DEFINED.—

(i) IN GENERAL.—For purposes of this paragraph, the term "current accrued benefit" means the individual's accrued benefit (at the close of the last year to which the amendments made by this section do not apply) when expressed as an annual benefit (within the meaning of section 415(b)(2) of such Code).

(ii) SPECIAL RULE.—For purposes of determining the amount of any individual's current accrued benefit—

(I) no change in the terms and conditions of the plan after May 5, 1986, and

(II) no cost-of-living adjustment occurring after May 5, 1986,

shall be taken into account. For purposes of subclause (I), any change in the terms and conditions of the plan pursuant to a collective bargaining agreement ratified before May 6, 1986, shall be treated as a change made before May 6, 1986.

(4) TRANSITION RULE WHERE THE SUM OF DEFINED CONTRIBUTION AND DEFINED BENEFIT PLAN FRACTIONS EXCEEDS 1.0.—In the case of a plan which satisfied the requirements of section 415 of the Internal Revenue Code of 1986 for its last year beginning before January 1, 1987, the Secretary of the Treasury or his delegate shall prescribe regulations under which an amount is subtracted from the numerator of the defined contribution plan fraction (not exceeding such numerator) so that the sum of the defined benefit plan fraction and the defined contribution plan fraction computed under section 415(e)(1) of such Code does not exceed 1.0 for such year.

(5) EFFECTIVE DATE FOR SUBSECTION (d).—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendment made by subsection (d) shall apply to benefits accruing in years beginning after December 31, 1988.

(B) COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan described in paragraph (2), the amendments made by subsection (d) shall apply to benefits accruing in years beginning on or after the earlier of—

(i) the later of—

(I) the date determined under paragraph (2)(A), or

(II) January 1, 1989, or

(ii) January 1, 1991.

(6) SPECIAL RULE FOR AMENDMENT MADE BY SUBSECTION (e).—The amendment made by subsection (e) shall not require the recomputation, for purposes of section 415(e) of the Internal Revenue Code of 1986, of the annual addition for any year beginning before 1987.

SEC. 1107. MODIFICATIONS OF SECTION 457.

(a) GENERAL RULE.—Section 457 (relating to deferred compensation plans with respect to service for State and local governments) is amended to read as follows:

"SEC. 457. DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

"(a) YEAR OF INCLUSION IN GROSS INCOME.—In the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary.

"(b) ELIGIBLE DEFERRED COMPENSATION PLAN DEFINED.—For purposes of this section, the term 'eligible deferred compensation plan' means a plan established and maintained by an eligible employer—

"(1) in which only individuals who perform service for the employer may be participants,

"(2) which provides that (except as provided in paragraph (3)) the maximum amount which may be deferred under the plan for the taxable year shall not exceed the lesser of—

"(A) $7,500, or

"(B) 33⅓ percent of the participant's includible compensation,

"(3) which may provide that, for 1 or more of the participant's last 3 taxable years ending before he attains normal retirement age under the plan, the ceiling set forth in paragraph (2) shall be the lesser of—

"(A) $15,000, or

"(B) the sum of—

"(i) the plan ceiling established for purposes of paragraph (2) for the taxable year (determined without regard to this paragraph), plus

"(ii) so much of the plan ceiling established for purposes of paragraph (2) for taxable years before the taxable year as has not previously been used under paragraph (2) or this paragraph,

"(4) which provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month,

"(5) which meets the distribution requirements of subsection (d), and

"(6) which provides that—

"(A) all amounts of compensation deferred under the plan,

"(B) all property and rights purchased with such amounts, and

"(C) all income attributable to such amounts, property, or rights,

shall remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

A plan which is established and maintained by an employer which is described in subsection (e)(1)(A) and which is administered in a manner which is inconsistent with the requirements of any of the preceding paragraphs shall be treated as not meeting the requirements of such paragraph as of the 1st plan year beginning more than 180 days after the date of notification by the Secretary of the inconsistency unless the employer corrects the inconsistency before the 1st day of such plan year.

"(c) INDIVIDUALS WHO ARE PARTICIPANTS IN MORE THAN 1 PLAN.—

"(1) IN GENERAL.—The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed $7,500 (as modified by any adjustment provided under subsection (b)(3)).

"(2) COORDINATION WITH CERTAIN OTHER DEFERRALS.—In applying paragraph (1) of this subsection and paragraphs (2) and (3) of subsection (b)—

"(A) any amount excluded from gross income under section 403(b) for the taxable year, and

"(B) any amount—

"(i) excluded from gross income under section 402(a)(8) or section 402(h)(1)(B) for the taxable year, or

"(ii) with respect to which a deduction is allowable by reason of a contribution to an organization described in section 501(c)(18) for the taxable year,

shall be treated as an amount deferred under subsection (a). In applying section 402(g)(8)(A)(iii) or 403(b)(2)(A)(ii), an amount deferred under subsection (a) for any year of service shall be taken into account as if described in section 402(g)(3)(C) or 403(b)(2)(A)(ii), respectively. Subparagraph (B) shall not apply in the case of a participant in a rural electric cooperative plan (as defined in section 401(k)(7)).

"(d) DISTRIBUTION REQUIREMENTS.—

"(1) IN GENERAL.—For purposes of subsection (b)(5), a plan meets the distribution requirements of this subsection if—

"(A) the plan provides that amounts payable under the plan will be made available to participants or other beneficiaries not earlier than when the participant is separated from service with the employer or is faced with an unforeseeable emergency (determined in the manner prescribed by the Secretary by regulation), and

"(B) the plan meets the minimum distribution requirements of paragraph (2).

"(2) MINIMUM DISTRIBUTION REQUIREMENTS.—A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of subparagraphs (A), (B), and (C):

"(A) APPLICATION OF SECTION 401(a)(9).—A plan meets the requirements of this subparagraph if the plan meets the requirements of section 401(a)(9).

"(B) ADDITIONAL DISTRIBUTION REQUIREMENTS.—A plan meets the requirements of this subparagraph if—

"(i) in the case of a distribution beginning before the death of the participant, such distribution will be made in a form under which—

"(I) at least ⅔ of the total amount payable with respect to the participant will be paid during the life expectancy of such participant (determined as of the commencement of the distribution), and

"(II) any amount not distributed to the participant during his life will be distributed after the death of the participant at least as rapidly as under the method of distributions being used under subclause (I) as of the date of his death, or

"(ii) in the case of a distribution which does not begin before the death of the participant, the entire amount payable with respect to the participant will be paid during a period not to exceed 15 years (or the life expectancy of the surviving spouse if such spouse is the beneficiary).

"(C) Nonincreasing benefits.—A plan meets the requirements of this subparagraph if any distribution payable over a period of more than 1 year can only be made in substantially nonincreasing amounts (paid not less frequently than annually).

"(e) Other Definitions and Special Rules.—For purposes of this section—

"(1) Eligible employer.—The term 'eligible employer' means—

"(A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and

"(B) any other organization (other than a governmental unit) exempt from tax under this subtitle.

"(2) Performance of service.—The performance of service includes performance of service as an independent contractor and the person (or governmental unit) for whom such services are performed shall be treated as the employer.

"(3) Participant.—The term 'participant' means an individual who is eligible to defer compensation under the plan.

"(4) Beneficiary.—The term 'beneficiary' means a beneficiary of the participant, his estate, or any other person whose interest in the plan is derived from the participant.

"(5) Includible compensation.—The term 'includible compensation' means compensation for service performed for the employer which (taking into account the provisions of this section and other provisions of this chapter) is currently includible in gross income.

"(6) Compensation taken into account at present value.—Compensation shall be taken into account at its present value.

"(7) Community property laws.—The amount of includible compensation shall be determined without regard to any community property laws.

"(8) Income attributable.—Gains from the disposition of property shall be treated as income attributable to such property.

"(9) Benefits not treated as made available by reason of certain elections.—If—

"(A) the total amount payable to a participant under the plan does not exceed $3,500, and

"(B) no additional amounts may be deferred under the plan with respect to the participant,

the amount payable to the participant under the plan shall not be treated as made available merely because such participant may elect to receive a lump sum payable within 60 days of the election.

"(10) Transfers between plans.—A participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from 1 eligible deferred compensation plan to another eligible deferred compensation plan.

"(f) Tax Treatment of Participants Where Plan or Arrangement of Employer Is Not Eligible.—

"(1) In general.—In the case of a plan of an eligible employer providing for a deferral of compensation, if such plan is not an eligible deferred compensation plan, then—

"(A) the compensation shall be included in the gross income of the participant or beneficiary for the 1st taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and

"(B) the tax treatment of any amount made available under the plan to a participant or beneficiary shall be determined under section 72 (relating to annuities, etc.).

"(2) Exceptions.—Paragraph (1) shall not apply to—

"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan or contract described in section 403,

"(C) that portion of any plan which consists of a transfer of property described in section 83, and

"(D) that portion of any plan which consists of a trust to which section 402(b) applies.

"(3) Definitions.—For purposes of this subsection—

"(A) Plan includes arrangements, etc.—The term 'plan' includes any agreement or arrangement.

"(B) Substantial risk of forfeiture.—The rights of a person to compensation are subject to a substantial risk of forfeiture if such person's rights to such compensation are conditioned upon the future performance of substantial services by any individual."

(b) Clerical Amendment.—The table of sections for subpart B of part II of subchapter E of chapter 1 is amended by striking out the item relating to section 457 and inserting in lieu thereof the following:

"Sec. 457. Deferred compensation plans of State and local governments and tax-exempt organizations."

(c) Effective Date.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1988.

(2) Transfers and cash-outs.—Paragraphs (9) and (10) of section 457(e) of the Internal Revenue Code of 1986 (as amended by this section) shall apply to taxable years beginning after December 31, 1986.

(3) Application to tax-exempt organizations.—

(A) In general.—Except as provided in subparagraph (B), the application of section 457 of the Internal Revenue Code of 1986 by reason of the amendments made by this section to eligible deferred compensation plans established and maintained by organizations exempt from tax shall apply to taxable years beginning after December 31, 1986.

(B) Existing deferrals and arrangements.—Section 457 of such Code shall not apply to amounts deferred under a plan described in subparagraph (A) which—

(i) were deferred from taxable years beginning before January 1, 1987, or

(ii) are deferred from taxable years beginning after December 31, 1986, pursuant to an agreement which—

(I) was in writing on August 16, 1986,

(II) on such date provides for a deferral for each taxable year covered by the agreement of a fixed amount or of an amount determined pursuant to a fixed formula.

Clause (ii) shall not apply to any taxable year ending after the date on which any modification to the amount or formula described in subclause (II) is effective. Amounts described in the first sentence shall be taken into account for applying section 457 to other amounts deferred under any eligible deferred compensation plan.

(4) DEFERRED COMPENSATION PLANS FOR STATE JUDGES.—The amendments made by this section shall not apply to any qualified State judicial plan (as defined in section 131(c)(3)(B) of the Revenue Act of 1978 as amended by section 252 of the Tax Equity and Fiscal Responsibility Act of 1982).

(5) SPECIAL RULE FOR CERTAIN DEFERRED COMPENSATION PLANS.—The amendments made by this section shall not apply to employees on August 16, 1986, of—

(A) a deferred compensation plan of a nonprofit corporation organized under the laws of the State of Alabama with respect to which the Internal Revenue Service issued a ruling dated March 17, 1976, that the plan would not affect the tax-exempt status of the corporation, or

(B) a deferred compensation plan with respect to which a letter dated November 6, 1975, submitted the original plan to the Internal Revenue Service, an amendment was submitted on November 19, 1975, and the Internal Revenue Service responded with a letter dated December 24, 1975,

but only with respect to deferrals under such plan.

SEC. 1108. SPECIAL RULES FOR SIMPLIFIED EMPLOYEE PENSIONS.

(a) SALARY REDUCTION ARRANGEMENTS PERMITTED.—Section 408(k) (relating to simplified employee pension defined) is amended by inserting after paragraph (5) the following new paragraph:

"(6) EMPLOYEE MAY ELECT SALARY REDUCTION ARRANGEMENT.—

"(A) IN GENERAL.—A simplified employee pension shall not fail to meet the requirements of this subsection for a year merely because, under the terms of the pension—

"(i) an employee may elect to have the employer make payments—

"(I) as elective employer contributions to the simplified employee pension on behalf of the employee, or

"(II) to the employee directly in cash,

"(ii) an election described in clause (i)(I) is made or is in effect with respect to not less than 50 percent of the employees of the employer, and

"(iii) the deferral percentage for such year of each highly compensated employee eligible to participate is not more than the product derived by multiplying the

average of the deferral percentages for such year of all employees (other than highly compensated employees) eligible to participate by 1.25.

"(B) Exception where more than 25 employees.—This paragraph shall not apply with respect to any year in the case of a simplified employee pension maintained by an employer with more than 25 employees at any time during the preceding year.

"(C) Distributions of excess contributions.—

"(i) In general.—Rules similar to the rules of section 401(k)(8) shall apply to any excess contribution under this paragraph. Any excess contribution under a simplified employee pension shall be treated as an excess contribution for purposes of section 4979.

"(ii) Excess contribution.—For purposes of clause (i), the term 'excess contribution' means, with respect to a highly compensated employee, the excess of elective employer contributions under this paragraph over the maximum amount of such contributions allowable under subparagraph (A)(iii).

"(D) Deferral percentage.—For purposes of this paragraph, the deferral percentage for an employee for a year shall be the ratio of—

"(i) the amount of elective employer contributions actually paid over to the simplified employee pension on behalf of the employee for the year, to

"(ii) the employee's compensation (within the meaning of section 414(s)) for the year.

"(E) Exception for state and local and tax-exempt pensions.—This paragraph shall not apply to a simplified employee pension maintained by—

"(i) a State or local government or political subdivision thereof, or any agency or instrumentality thereof, or

"(ii) an organization exempt from tax under this title.

"(F) Highly compensated employee.—For purposes of this paragraph, the term 'highly compensated employee' has the meaning given such term by section 414(q)."

(b) Exclusion From Gross Income.—Section 402 (relating to taxability of beneficiary of employees' trust), as amended by section 1105(a), is amended by inserting at the end thereof the following new subsection:

"(h) Special Rules for Simplified Employee Pensions.—For purposes of this chapter—

"(1) In general.—Except as provided in paragraph (2), contributions made by an employer on behalf of an employee to an individual retirement plan pursuant to a simplified employee pension (as defined in section 408(k))—

"(A) shall not be treated as distributed or made available to the employee or as contributions made by the employee, and

"(B) if such contributions are made pursuant to an arrangement under section 408(k)(6) under which an employee

may elect to have the employer make contributions to the simplified employee pension on behalf of the employee, shall not be treated as distributed or made available or as contributions made by the employee merely because the simplified employee pension includes provisions for such election.

"(2) Limitations on employer contributions.—Contributions made by an employer to a simplified employee pension with respect to an employee for any year shall be treated as distributed or made available to such employee and as contributions made by the employee to the extent such contributions exceed the lesser of—

"(A) 15 percent of the compensation (within the meaning of section 414(s)) from such employer includible in the employee's gross income for the year (determined without regard to the employer contributions to the simplified employee pension), or

"(B) the limitation in effect under section 415(c)(1)(A), reduced in the case of any highly compensated employee (within the meaning of section 414(q)) by the amount taken into account with respect to such employee under section 408(k)(3)(D).

"(3) Distributions.—Any amount paid or distributed out of an individual retirement plan pursuant to a simplified employee pension shall be included in gross income by the payee or distributee, as the case may be, in accordance with the provisions of section 408(d)."

(c) Deductibility of Contributions.—Subparagraphs (A) and (B) of section 404(h)(1) (relating to special rules for simplified employee pensions) are amended to read as follows:

"(A) Contributions made for a year are deductible—

"(i) in the case of a simplified employee pension maintained on a calendar year basis, for the taxable year with or within which the calendar year ends, or

"(ii) in the case of a simplified employee pension which is maintained on the basis of the taxable year of the employer, for such taxable year.

"(B) Contributions shall be treated for purposes of this subsection as if they were made for a taxable year if such contributions are made on account of such taxable year and are made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof)."

(d) Participation Requirements.—Paragraph (2) of section 408(k) (relating to participation requirements) is amended to read as follows:

"(2) Participation requirements.—This paragraph is satisfied with respect to a simplified employee pension for a year only if for such year the employer contributes to the simplified employee pension of each employee who—

"(A) has attained age 21,

"(B) has performed service for the employer during at least 3 of the immediately preceding 5 years, and

"(C) received at least $300 in compensation (within the meaning of section 414(q)(7)) from the employer for the year. For purposes of this paragraph, there shall be excluded from consideration employees described in subparagraph (A) or (C) of section 410(b)(3). For purposes of any arrangement described in subsection (k)(6), any employee who is eligible to have employer contributions made on the employee's behalf under such arrangement shall be treated as if such a contribution was made."

(e) Cost-of-Living Adjustments.—Section 408(k) is amended by adding at the end thereof the following new paragraph:

"(8) Cost-of-living adjustment.—The Secretary shall adjust the $300 amount in paragraph (2)(C) and the $200,000 amount in paragraph (3)(C) at the same time and in the same manner as under section 415(d)."

(f) Computation Period.—Section 408(k)(7) is amended by adding at the end thereof the following new subparagraph:

"(C) Year.—The term 'year' means—

"(i) the calendar year, or

"(ii) if the employer elects, subject to such terms and conditions as the Secretary may prescribe, to maintain the simplified employee pension on the basis of the employer's taxable year, the employer's taxable year."

(g) Conforming Amendments.—

(1) Section 408(k)(3) (relating to nondiscrimination requirements) is amended—

(A) by striking out all that follows "in favor of" in subparagraph (A) and inserting in lieu thereof "any highly compensated employee (within the meaning of section 414(q)).",

(B) in subparagraph (C)—

(i) by inserting "and except as provided in subparagraph (D)," after "subparagraph (A),",

(ii) by inserting "(other than contributions under an arrangement described in paragraph (6))" after "employer contributions to simplified employee pensions", and

(iii) by striking out the last sentence thereof, and

(C) by striking out subparagraphs (D) and (E) and inserting in lieu thereof:

"(D) Permitted disparity.—For purposes of subparagraph (C), the rules of section 401(l)(2) shall apply to contributions to simplified employee pensions (other than contributions under an arrangement described in paragraph (6))."

(2) Paragraph (2) of section 219(b) is amended to read as follows:

"(2) Special rule for employer contributions under simplified employee pensions.—This section shall not apply with respect to an employer contribution to a simplified employee pension."

(3) Section 219(c)(2)(B) is amended by striking out "(determined without regard to so much of the employer contributions to a simplified employee pension as is allowable by reason of paragraph (2) of subsection (b))".

(4) Section 408(k)(3)(A) is amended by striking out "calendar".

(5) Section 415(c)(2) is amended by striking out "allowable as a deduction under section 219(a), and without regard to deductible employee contributions within the meaning of section 72(o)(5)" and inserting in lieu thereof "which are excludable from gross income under section 408(k)(6)".

(6) Section 408(k), as amended by subsection (e), is amended by adding at the end thereof the following new paragraph:

"(9) CROSS REFERENCE.—

"For excise tax on certain excess contributions, see section 4979."

(7) Section 3121(a)(5) is amended by striking out subparagraph (C) and inserting in lieu thereof the following subparagraph:

"(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),".

(8) Section 3306(b)(5) is amended by striking out subparagraph (C) and inserting in lieu thereof the following subparagraph:

"(C) under a simplified employee pension (as defined in section 408(k)(1)), other than any contributions described in section 408(k)(6),".

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 1986.

SEC. 1109. DEDUCTIBLE CONTRIBUTIONS PERMITTED UNDER SECTION 501(c)(18) PLAN.

(a) IN GENERAL.—Section 501(c)(18) is amended by striking out "and" at the end of subparagraph (B), by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and" and by adding at the end thereof the following new subparagraph:

"(D) in the case of a plan under which an employee may designate certain contributions as deductible—

"(i) such contributions do not exceed the amount with respect to which a deduction is allowable under section 219(b)(3),

"(ii) requirements similar to the requirements of section 401(k)(3)(A)(ii) are met with respect to such elective contributions, and

"(iii) such contributions are treated as elective deferrals for purposes of section 402(g) (other than paragraph (4) thereof).

For purposes of subparagraph (D)(ii), rules similar to the rules of section 401(k)(8) shall apply. For purposes of section 4979, any excess contribution under clause (ii) shall be treated as an excess contribution under a cash or deferred arrangement."

(b) LIMITATION ON DEDUCTION.—Section 219(b), as amended by section 1101(b), is amended by adding at the end thereof the following new paragraph:

"(3) PLANS UNDER SECTION 501(c)(18).—Notwithstanding paragraph (1), the amount allowable as a deduction under subsection (a) with respect to any contributions on behalf of an employee to a plan described in section 501(c)(18) shall not exceed the lesser of—

"(A) $7,000, or

"(B) an amount equal to 25 percent of the compensation (as defined in section 415(c)(3)) includible in the individual's gross income for such taxable year."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

PART II—NONDISCRIMINATION REQUIREMENTS

SEC. 1111. APPLICATION OF NONDISCRIMINATION RULES TO INTEGRATED PLANS.

(a) IN GENERAL.—Section 401(l) (relating to nondiscriminatory coordination of defined contribution plans with OASDI) is amended to read as follows:

"(l) PERMITTED DISPARITY IN PLAN CONTRIBUTIONS OR BENEFITS.—

"(1) IN GENERAL.—The requirements of this subsection are met with respect to a plan if—

"(A) in the case of a defined contribution plan, the requirements of paragraph (2) are met, and

"(B) in the case of a defined benefit plan, the requirements of paragraph (3) are met.

"(2) DEFINED CONTRIBUTION PLAN.—

"(A) IN GENERAL.—A defined contribution plan meets the requirements of this paragraph if the excess contribution percentage does not exceed the base contribution percentage by more than the lesser of—

"(i) the base contribution percentage, or

"(ii) the greater of—

"(I) 5.7 percentage points, or

"(II) the percentage equal to the portion of the rate of tax under section 3111(a) (in effect as of the beginning of the year) which is attributable to old-age insurance.

"(B) CONTRIBUTION PERCENTAGES.—For purposes of this paragraph—

"(i) EXCESS CONTRIBUTION PERCENTAGE.—The term 'excess contribution percentage' means the percentage of compensation which is contributed under the plan with respect to that portion of each participant's compensation in excess of the integration level.

"(ii) BASE CONTRIBUTION PERCENTAGE.—The term 'base contribution percentage' means the percentage of compensation contributed under the plan with respect to that portion of each participant's compensation not in excess of the integration level.

"(3) DEFINED BENEFIT PLAN.—A defined benefit plan meets the requirements of this paragraph if—

"(A) EXCESS PLANS.—

"(i) IN GENERAL.—In the case of a plan other than an offset plan—

"(I) the excess benefit percentage does not exceed the base benefit percentage by more than the maximum excess allowance,

"(II) any optional form of benefit, preretirement benefit, actuarial factor, or other benefit or feature provided with respect to compensation in excess of the integration level is provided with respect to compensation not in excess of such level, and

"(III) benefits are based on average annual compensation.

"(ii) BENEFIT PERCENTAGES.—For purposes of this subparagraph, the excess and base benefit percentages shall be computed in the same manner as the excess and base contribution percentages under paragraph (2)(B), except that such determination shall be made on the basis of benefits rather than contributions.

"(B) OFFSET PLANS.—In the case of an offset plan, the plan provides that—

"(i) a participant's accrued benefit attributable to employer contributions (within the meaning of section 411(c)(1)) may not be reduced (by reason of the offset) by more than the maximum offset allowance, and

"(ii) benefits are based on average annual compensation.

"(4) DEFINITIONS RELATING TO PARAGRAPH (3).—For purposes of paragraph (3)—

"(A) MAXIMUM EXCESS ALLOWANCE.—The maximum excess allowance is equal to—

"(i) in the case of benefits attributable to any year of service with the employer taken into account under the plan, 3/4 of a percentage point, and

"(ii) in the case of total benefits, 3/4 of a percentage point, multiplied by the participant's years of service (not in excess of 35) with the employer taken into account under the plan.

In no event shall the maximum excess allowance exceed the base benefit percentage.

"(B) MAXIMUM OFFSET ALLOWANCE.—The maximum offset allowance is equal to—

"(i) in the case of benefits attributable to any year of service with the employer taken into account under the plan, ¾ percent of the participant's final average compensation, and

"(ii) in the case of total benefits, ¾ percent of the participant's final average compensation, multiplied by the participant's years of service (not in excess of 35) with the employer taken into account under the plan.

In no event shall the maximum offset allowance exceed 50 percent of the benefit which would have accrued without regard to the offset reduction.

"(C) REDUCTIONS.—

"(i) IN GENERAL.—The Secretary shall prescribe regulations requiring the reduction of the ¾ percentage factor under subparagraph (A) or (B)—

"(I) in the case of a plan other than an offset plan which has an integration level in excess of covered compensation, or

"(II) with respect to any participant in an offset plan who has final average compensation in excess of covered compensation.

"(ii) BASIS OF REDUCTIONS.—Any reductions under clause (i) shall be based on the percentages of compensation replaced by the employer-derived portions of primary insurance amounts under the Social Security Act for participants with compensation in excess of covered compensation.

"(D) OFFSET PLAN.—The term 'offset plan' means any plan with respect to which the benefit attributable to employer contributions for each participant is reduced by an amount specified in the plan.

"(5) OTHER DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) INTEGRATION LEVEL.—

"(i) IN GENERAL.—The term 'integration level' means the amount of compensation specified under the plan (by dollar amount or formula) at or below which the rate at which contributions or benefits are provided (expressed as a percentage) is less than such rate above such amount.

"(ii) LIMITATION.—The integration level for any year may not exceed the contribution and benefit base in effect under section 230 of the Social Security Act for such year.

"(iii) LEVEL TO APPLY TO ALL PARTICIPANTS.—A plan's integration level shall apply with respect to all participants in the plan.

"(iv) MULTIPLE INTEGRATION LEVELS.—Under rules prescribed by the Secretary, a defined benefit plan may specify multiple integration levels.

"(B) COMPENSATION.—The term 'compensation' has the meaning given such term by section 414(s).

"(C) AVERAGE ANNUAL COMPENSATION.—The term 'average annual compensation' means the greater of—

"(i) the participant's final average compensation (determined without regard to subparagraph (D)(ii)), or

"(ii) the participant's highest average annual compensation for any other period of at least 3 consecutive years.

"(D) FINAL AVERAGE COMPENSATION.—

"(i) IN GENERAL.—The term 'final average compensation' means the participant's average annual compensation for—

"(I) the 3-consecutive year period ending with the current year, or

"(II) if shorter, the participant's full period of service.

"(ii) LIMITATION.—A participant's final average compensation shall be determined by not taking into account in any year compensation in excess of the contribution and benefit base in effect under section 230 of the Social Security Act for such year.

"(E) Covered compensation.—

"(i) In general.—The term 'covered compensation' means, with respect to an employee, the average of the contribution and benefit bases in effect under section 230 of the Social Security Act for each year in the 35-year period ending with the year in which the employee attains age 65.

"(ii) Computation for any year.—For purposes of clause (i), the determination for any year preceding the year in which the employee attains age 65 shall be made by assuming that there is no increase in the bases described in clause (i) after the determination year and before the employee attains age 65.

"(F) Regulations.—The Secretary shall prescribe such regulations as are necessary or appropriate to carry out the purposes of this subsection, including—

"(i) in the case of a defined benefit plan which provides for unreduced benefits commencing before the social security retirement age (as defined in section 415(b)(8)), rules providing for the reduction of the maximum excess allowance and the maximum offset allowance, and

"(ii) in the case of an employee covered by 2 or more plans of the employer which fail to meet the requirements of subsection (a)(4) (without regard to this subsection), rules preventing the multiple use of the disparity permitted under this subsection with respect to any employee.

For purposes of clause (i), unreduced benefits shall not include benefits for disability (within the meaning of section 223(d) of the Social Security Act).

"(6) Special rule for plan maintained by railroads.—In determining whether a plan which includes employees of a railroad employer who are entitled to benefits under the Railroad Retirement Act of 1974 meets the requirements of this subsection, rules similar to the rules set forth in this subsection shall apply. Such rules shall take into account the employer-derived portion of the employees' tier 2 railroad retirement benefits and any supplemental annuity under the Railroad Retirement Act of 1974."

(b) Conforming Amendment.—Paragraph (5) of section 401(a) is amended to read as follows:

"(5) Special rules relating to nondiscrimination requirements.—

"(A) Salaried or clerical employees.—A classification shall not be considered discriminatory within the meaning of paragraph (4) or section 410(b)(2)(A)(i) merely because it is limited to salaried or clerical employees.

"(B) Contributions and benefits may bear uniform relationship to compensation.—A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan bear a uniform relation-

best copy available

ship to the compensation (within the meaning of section 414(s)) of such employees.

"(C) CERTAIN DISPARITY PERMITTED.—A plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the contributions or benefits of, or on behalf of, the employees under the plan favor highly compensated employees (as defined in section 414(q)) in the manner permitted under subsection (l).

"(D) INTEGRATED DEFINED BENEFIT PLAN.—

"(i) IN GENERAL.—A defined benefit plan shall not be considered discriminatory within the meaning of paragraph (4) merely because the plan provides that the employer-derived accrued retirement benefit for any participant under the plan may not exceed the excess (if any) of—

"(I) the participant's final pay with the employer, over

"(II) the employer-derived retirement benefit created under Federal law attributable to service by the participant with the employer.

For purposes of this clause, the employer-derived retirement benefit created under Federal law shall be treated as accruing ratably over 35 years.

"(ii) FINAL PAY.—For purposes of this subparagraph, the participant's final pay is the compensation (as defined in section 414(q)(7)) paid to the participant by the employer for any year—

"(I) which ends during the 5-year period ending with the year in which the participant separated from service for the employer, and

"(II) for which the participant's total compensation from the employer was highest.

"(E) 2 OR MORE PLANS TREATED AS SINGLE PLAN.—For purposes of determining whether 2 or more plans of an employer satisfy the requirements of paragraph (4) when considered as a single plan—

"(i) CONTRIBUTIONS.—If the amount of contributions on behalf of the employees allowed as a deduction under section 404 for the taxable year with respect to such plans, taken together, bears a uniform relationship to the compensation (within the meaning of section 414(s)) of such employees, the plans shall not be considered discriminatory merely because the rights of employees to, or derived from, the employer contributions under the separate plans do not become nonforfeitable at the same rate.

"(ii) BENEFITS.—If the employees' rights to benefits under the separate plans do not become nonforfeitable at the same rate, but the levels of benefits provided by the separate plans satisfy the requirements of regulations prescribed by the Secretary to take account of the differences in such rates, the plans shall not be considered discriminatory merely because of the difference in such rates."

(c) Effective Date.—

(1) Subsection (a).—The amendments made by subsection (a) shall apply to benefits attributable to plan years beginning after December 31, 1988.

(2) Subsection (b).—The amendments made by subsection (b) shall apply to years beginning after December 31, 1988.

(3) Special rule for collective bargaining agreements.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to benefits pursuant to, and individuals covered by, any such agreement in plan years beginning before the earlier of—

(A) the later of—

(i) January 1, 1989, or

(ii) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1991.

SEC. 1112. MINIMUM COVERAGE REQUIREMENTS FOR QUALIFIED PLANS.

(a) In General.—Subsection (b) of section 410 (relating to eligibility requirements) is amended to read as follows:

"(b) Minimum Coverage Requirements.—

"(1) In general.—A trust shall not constitute a qualified trust under section 401(a) unless such trust is designated by the employer as part of a plan which meets 1 of the following requirements:

"(A) The plan benefits at least 70 percent of employees who are not highly compensated employees.

"(B) The plan benefits—

"(i) a percentage of employees who are not highly compensated employees which is at least 70 percent of

"(ii) the percentage of highly compensated employees benefiting under the plan.

"(C) The plan meets the requirements of paragraph (2).

"(2) Average benefit percentage test.—

"(A) In general.—A plan shall be treated as meeting the requirements of this paragraph if—

"(i) the plan benefits such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated employees, and

"(ii) the average benefit percentage for employees who are not highly compensated employees is at least 70 percent of the average benefit percentage for highly compensated employees.

"(B) Average benefit percentage.—For purposes of this paragraph, the term 'average benefit percentage' means, with respect to any group, the average of the benefit percentages calculated separately with respect to each employee in such group (whether or not a participant in any plan).

"(C) Benefit percentage.—For purposes of this paragraph—

"(i) In general.—The term 'benefit percentage' means the employer-provided contribution or benefit of an employee under all qualified plans maintained by the employer, expressed as a percentage of such employee's compensation (within the meaning of section 414(s)).

"(ii) Period for computing percentage.—At the election of an employer, the benefit percentage for any plan year shall be computed on the basis of contributions or benefits for—

"(I) such plan year, or

"(II) any consecutive plan year period (not greater than 3 years) which ends with such plan year and which is specified in such election.

An election under this clause, once made, may be revoked or modified only with the consent of the Secretary.

"(D) Employees taken into account.—For purposes of determining who is an employee for purposes of determining the average benefit percentage under subparagraph (B)—

"(i) except as provided in clause (ii), paragraph (4)(A) shall not apply, or

"(ii) if the employer elects, paragraph (4)(A) shall be applied by using the lowest age and service requirements of all qualified plans maintained by the employer.

"(E) Qualified plan.—For purposes of this paragraph, the term 'qualified plan' means any plan which (without regard to this subsection) meets the requirements of section 401(a).

"(3) Exclusion of certain employees.—For purposes of this subsection, there shall be excluded from consideration—

"(A) employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers,

"(B) in the case of a trust established or maintained pursuant to an agreement which the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with title II of the Railway Labor Act and one or more employers, all employees not covered by such agreement, and

"(C) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

Subparagraph (A) shall not apply with respect to coverage of employees under a plan pursuant to an agreement under such *subparagraph. Subparagraph (B) shall not apply in the case of a plan which provides contributions or benefits for employees whose principal duties are not customarily performed aboard aircraft in flight.*

"(4) Exclusion of employees not meeting age and service requirements.—

"(A) In general.—If a plan—

"(i) prescribes minimum age and service requirements as a condition of participation, and

"(ii) excludes all employees not meeting such requirements from participation,

then such employees shall be excluded from consideration for purposes of this subsection.

"(B) Requirements may be met separately with respect to excluded group.—If employees do not meet the minimum age or service requirements of subsection (a)(1) (without regard to subparagraph (B) thereof) and are covered under a plan of the employer which meets the requirements of paragraph (1) separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets the requirements of paragraph (1).

"(5) Line of business exception.—

"(A) In general.—If, under section 414(r), an employer is treated as operating separate lines of business for a year, the employer may apply the requirements of this subsection for such year separately with respect to employees in each separate line of business.

"(B) Plan must be nondiscriminatory.—Subparagraph (A) shall not apply with respect to any plan maintained by an employer unless such plan benefits such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated employees.

"(6) Definitions and special rules.—For purposes of this subsection—

"(A) Highly compensated employee.—The term 'highly compensated employee' has the meaning given such term by section 414(q).

"(B) Aggregation rules.—An employer may elect to designate—

"(i) 2 or more trusts,

"(ii) 1 or more trusts and 1 or more annuity plans, or

"(iii) 2 or more annuity plans,

as part of 1 plan intended to qualify under section 401(a) to determine whether the requirements of this subsection are met with respect to such trusts or annuity plans. If an employer elects to treat any trusts or annuity plans as 1 plan under this subparagraph, such trusts or annuity plans shall be treated as 1 plan for purposes of section 401(a)(4).

"(C) Special rules for certain dispositions or acquisitions.—

"(i) In general.—If a person becomes, or ceases to be, a member of a group described in subsection (b), (c),

(m), or (o) of section 414, then the requirements of this subsection shall be treated as having been met during the transition period with respect to any plan covering employees of such person or any other member of such group if—

"(I) such requirements were met immediately before each such change, and

"(II) the coverage under such plan is not significantly changed during the transition period (other than by reason of the change in members of a group).

"(ii) TRANSITION PERIOD.—For purposes of clause (i), the term 'transition period' means the period—

"(I) beginning on the date of the change in members of a group, and

"(II) ending on the last day of the 1st plan year beginning after the date of such change.

"(D) SPECIAL RULE FOR CERTAIN EMPLOYEE STOCK OWNERSHIP PLANS.—A trust which is part of a tax credit employee stock ownership plan which is the only plan of an employer intended to qualify under section 401(a) shall not be treated as not a qualified trust under section 401(a) solely because it fails to meet the requirements of this subsection if—

"(i) such plan benefits 50 percent or more of all the employees who are eligible under a nondiscriminatory classification under the plan, and

"(ii) the sum of the amounts allocated to each participant's account for the year does not exceed 2 percent of the compensation of that participant for the year.

"(E) ELIGIBILITY TO CONTRIBUTE.—In the case of contributions which are subject to section 401(k) or 401(m), employees who are eligible to contribute (or elect to have contributions made on their behalf) shall be treated as benefiting under the plan (other than for purposes of paragraph (2)(A)(ii)).

"(F) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection."

(b) ADDITIONAL PARTICIPATION REQUIREMENTS.—Section 401(a) (relating to qualification requirements) is amended by adding at the end thereof the following new paragraph:

"(26) ADDITIONAL PARTICIPATION REQUIREMENTS.—

"(A) IN GENERAL.—A trust shall not constitute a qualified trust under this subsection unless such trust is part of a plan which on each day of the plan year benefits the lesser of—

"(i) 50 employees of the employer, or

"(ii) 40 percent or more of all employees of the employer.

"(B) TREATMENT OF EXCLUDABLE EMPLOYEES.—

"(i) IN GENERAL.—A plan may exclude from consideration under this paragraph employees described in paragraphs (3) and (4)(A) of section 410(b).

"(ii) Separate application for certain excludable employees.—If employees described in section 410(b)(4)(B) are covered under a plan which meets the requirements of subparagraph (A) separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets such requirements if—

"(I) the benefits for such employees are provided under the same plan as benefits for other employees,

"(II) the benefits provided to such employees are not greater than comparable benefits provided to other employees under the plan, and

"(III) no highly compensated employee (within the meaning of section 414(q)) is included in the group of such employees for more than 1 year.

"(C) Eligibility to participate.—In the case of contributions under section 401(k) or 401(m), employees who are eligible to contribute (or may elect to have contributions made on their behalf) shall be treated as benefiting under the plan.

"(D) Special rule for collective bargaining units.—Except to the extent provided in regulations, a plan covering only employees described in section 410(b)(3)(A) may exclude from consideration any employees who are not included in the unit or units in which the covered employees are included.

"(E) Paragraph not to apply to multiemployer plans.—Except to the extent provided in regulations, this paragraph shall not apply to employees in a multiemployer plan (within the meaning of section 414(f)) who are covered by collective bargaining agreements.

"(F) Regulations.—The Secretary may by regulation provide that any separate benefit structure, any separate trust, or any other separate arrangement is to be treated as a separate plan for purposes of applying this paragraph."

(c) Plans Failing To Meet Requirements of Section 410(b).—

(1) In general.—Subsection (b) of section 402 (relating to taxability of beneficiary of nonexempt trust) is amended by adding at the end thereof the following new paragraph:

"(2) Failure to meet requirements of section 410(b).—

"(A) In general.—In the case of a trust which is not exempt from tax under section 501(a) solely because such trust is part of a plan which fails to meet the requirements of section 410(b)—

"(i) such trust shall be treated as exempt from tax under section 501(a) for purposes of applying paragraph (1) to employees who are not highly compensated employees, and

"(ii) paragraph (1) shall be applied to the vested accrued benefit (other than employee contributions) of any highly compensated employee as of the close of the employer's taxable year described in paragraph (1) (rather than contributions made during such year).

"(B) FAILURE IN MORE THAN 1 YEAR.—If a plan fails to meet the requirements of section 410(b) for more than 1 taxable year, any portion of the vested accrued benefit to which subparagraph (A) applies shall be included in gross income only once.

"(C) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this paragraph, the term 'highly compensated employee' has the meaning given such term by section 414(q)."

(2) CONFORMING AMENDMENT.—The heading for section 402(b) is amended to read as follows:

"(b) TAXABILITY OF BENEFICIARY OF NONEXEMPT TRUST.—

"(1) IN GENERAL.—".

(d) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Section 401(k)(3)(A) is amended by striking out "subparagraph (A) or (B) of" before "section 410(b)(1)".

(2) Section 404(a)(2) is amended by striking out "and (22)" and inserting in lieu thereof "(22), and (26)".

(3) Sections 406(b)(1) and 407(b)(1) are each amended by striking out "(without regard to paragraph (1)(A) thereof)" after "section 410(b)".

(4) Section 818(a)(3) is amended by striking out "and (22)" and inserting in lieu thereof "(22), and (26)".

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan years beginning after December 31, 1988.

(2) SPECIAL RULE FOR COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to employees covered by any such agreement in plan years beginning before the earlier of—

(A) the later of—

(i) January 1, 1989, or

(ii) the date on which the last of such collective bargaining agreement terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1991.

(3) WAIVER OF EXCISE TAX ON REVERSIONS.—

(A) IN GENERAL.—If—

(i) a plan is in existence on August 16, 1986,

(ii) such plan would fail to meet the requirements of section 401(a)(26) of the Internal Revenue Code of 1986 (as added by subsection (b)) if such section were in effect for the plan year including August 16, 1986, and

(iii) there is no transfer of assets to or liabilities from a plan or merger or spinoff or merger involving such plan after August 16, 1986,

then no tax shall be imposed under section 4980 of such Code on any employer reversion by reason of the termination or merger of such plan before the 1st year to which the amendment made by subsection (b) applies.

(B) Determination of amount of reversion.—For purposes of the Internal Revenue Code of 1986, in determining the present value of the accrued benefit of any highly compensated employee (within the meaning of section 414(q) of such Code) on the termination or merger of any plan to which subparagraph (A) applies, the plan shall use the highest interest rate which may be used for calculating present value under section 411(a)(11)(B) of such Code.

(C) Special rule for plans which may not terminate.—To the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, if a plan is prohibited from terminating under title IV of the Employee Retirement Income Security Act of 1974 before the 1st year to which the amendment made by subsection (b) applies, subparagraph (A) shall be applied by substituting "the 1st year in which the plan is able to terminate" for "the 1st year to which the amendment made by subsection (b) applies".

SEC. 1113. MINIMUM VESTING STANDARDS.

(a) In General.—Paragraph (2) of section 411(a) (relating to minimum vesting standards) is amended to read as follows:

"(2) Employer contributions.—A plan satisfies the requirements of this paragraph if it satisfies the requirements of subparagraph (A), (B), or (C).

"(A) 5-year vesting.—A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

"(B) 3 to 7 year vesting.—A plan satisfies the requirements of this subparagraph if an employee has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table:

"Years of service:	***The nonforfeitable percentage is:***
3	*20*
4	*40*
5	*60*
6	*80*
7 or more	*100.*

"(C) Multiemployer plans.—A plan satisfies the requirements of this subparagraph if—

"(i) the plan is a multiemployer plan (within the meaning of section 414(f)), and

"(ii) under the plan—

"(I) an employee who is covered pursuant to a collective bargaining agreement described in section 414(f)(1)(B) and who has completed at least 10 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions, and

"(II) the requirements of subparagraph (A) or (B) are met with respect to employees not described in subclause (I)."

(b) Repeal of Class Year Vesting.—Paragraph (4) of section 411(d) (relating to class year vesting) is hereby repealed.

(c) Modification of Minimum Participation Standards.—Clause (i) of section 410(a)(1)(B) (relating to special rules for certain plans) is amended by striking out "3 years" each place it appears and inserting in lieu thereof "2 years".

(d) Conforming Amendments.—

(A) The heading for section 410(a)(5)(B) is amended by striking out "3-year" and inserting in lieu thereof "2-year".

(B) Section 411(a)(10)(B) is amended by striking out "5 years" and inserting in lieu thereof "3 years".

(e) Amendments to ERISA.—

(1) In general.—Paragraph (2) of section 203(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(a)(2)) is amended to read as follows:

"(2) A plan satisfies the requirements of this paragraph if it satisfies the following requirements of subparagraph (A), (B), or (C).

"(A) A plan satisfies the requirements of this subparagraph if an employee who has completed at least 5 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions.

"(B) A plan satisfies the requirements of this subparagraph if an employee has a nonforfeitable right to a percentage of the employee's accrued benefit derived from employer contributions determined under the following table:

"Years of service:	The nonforfeitable percentage is:
3	20
4	40
5	60
6	80
7 or more	100.

"(C) A plan satisfies the requirements of this subparagraph if—

"(i) the plan is a multiemployer plan (within the meaning of section 3(37)), and

"(ii) under the plan—

"(I) an employee who is covered pursuant to a collective bargaining agreement described in section 414(f)(1)(B) and who has completed at least 10 years of service has a nonforfeitable right to 100 percent of the employee's accrued benefit derived from employer contributions, and

"(II) the requirements of subparagraph (A) or (B) are met with respect to employees not described in subclause (I)."

(2) Repeal of class year vesting.—Subsection (c) of section 203 of such Act is amended by striking out paragraph (3).

(3) MINIMUM PARTICIPATION STANDARDS.—Section 202(B)(i) of such Act is amended by striking out "3 years" each place it appears and inserting in lieu thereof "2 years".

(4) CONFORMING AMENDMENTS.—

(A) MINIMUM VESTING STANDARDS.—Section 203(c)(1)(B) of such Act is amended by striking out "5 years" and inserting in lieu thereof "3 years".

(B) BENEFIT ACCRUAL REQUIREMENTS.—Subsection (i) of section 204 of such Act (29 U.S.C. 1054(i)) is amended to read as follows:

"(i) CROSS REFERENCE.—

"For special rules relating to plan provisions adopted to preclude discrimination, see section 203(c)(2).".

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to plan years beginning after December 31, 1988.

(2) SPECIAL RULE FOR COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to employees covered by any such agreement in plan years beginning before the earlier of—

(A) the later of—

(i) January 1, 1989, or

(ii) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1991.

(3) PARTICIPATION REQUIRED.—The amendments made by this section shall not apply to any employee who does not have 1 hour of service in any plan year to which the amendments made by this section apply.

SEC. 1114. DEFINITION OF HIGHLY COMPENSATED EMPLOYEE.

(a) GENERAL RULE.—Section 414 is amended by adding at the end thereof the following new subsection:

"(q) HIGHLY COMPENSATED EMPLOYEE.—

"(1) IN GENERAL.—The term 'highly compensated employee' means any employee who, during the year or the preceding year—

"(A) was at any time a 5-percent owner,

"(B) received compensation from the employer in excess of $75,000,

"(C) received compensation from the employer in excess of $50,000 and was in the top-paid group of employees for such year, or

"(D) was at any time an officer and received compensation greater than 150 percent of the amount in effect under section 415(c)(1)(A) for such year.

"(2) SPECIAL RULE FOR CURRENT YEAR.—In the case of the year for which the relevant determination is being made, an

employee not described in subparagraph (B), (C), or (D) of paragraph (1) for the preceding year (without regard to this paragraph) shall not be treated as described in subparagraph (B), (C), or (D) of paragraph (1) unless such employee is a member of the group consisting of the 100 employees paid the greatest compensation during the year for which such determination is being made.

"(3) 5-percent owner.—An employee shall be treated as a 5-percent owner for any year if at any time during such year such employee was a 5-percent owner (as defined in section 416(i)(1)) of the employer.

"(4) Top-paid group.—An employee is in the top-paid group of employees for any year if such employee is in the group consisting of the top 20 percent of the employees when ranked on the basis of compensation paid during such year.

"(5) Special rules for treatment of officers.—

"(A) Not more than 50 officers taken into account.—For purposes of paragraph (1)(D), no more than 50 employees (or, if lesser, the greater of 3 employees or 10 percent of the employees) shall be treated as officers.

"(B) At least 1 officer taken into account.—If for any year no officer of the employer is described in paragraph (1)(D), the highest paid officer of the employer for such year shall be treated as described in such paragraph.

"(6) Treatment of certain family members.—

"(A) In general.—If any individual is a member of the family of a 5-percent owner or of a highly compensated employee in the group consisting of the 10 highly compensated employees paid the greatest compensation during the year, then—

"(i) such individual shall not be considered a separate employee, and

"(ii) any compensation paid to such individual (and any applicable contribution or benefit on behalf of such individual) shall be treated as if it were paid to (or on behalf of) the 5-percent owner or highly compensated employee.

"(B) Family.—For purposes of subparagraph (A), the term 'family' means, with respect to any employee, such employee's spouse and lineal ascendants or descendants and the spouses of such lineal ascendants or descendants.

"(7) Compensation.—For purposes of this subsection—

"(A) In general.—The term 'compensation' means compensation within the meaning of section 415(c)(3).

"(B) Certain provisions not taken into account.—The determination under subparagraph (A) shall be made—

"(i) without regard to sections 125, 402(a)(8), and 402(h)(1)(B), and

"(ii) in the case of employer contributions made pursuant to a salary reduction agreement, without regard to section 403(b).

"(8) Excluded employees.—For purposes of subsection (r) and for purposes of determining the number of employees in the

top-paid group under paragraph (4), the following employees shall be excluded—

"(A) employees who have not completed 6 months of service,

"(B) employees who normally work less than 17½ hours per week,

"(C) employees who normally work during not more than 6 months during any year,

"(D) employees who have not attained age 21,

"(E) except to the extent provided in regulations, employees who are included in a unit of employees covered by an agreement which the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and the employer, and

"(F) employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

The employer may elect to apply subparagraph (A), (B), (C), or (D) by substituting a shorter period of service, smaller number of hours or months, or lower age for the period of service, number of hours or months, or age (as the case may be) than that specified in such subparagraph.

"(9) FORMER EMPLOYEES.—A former employee shall be treated as a highly compensated employee if—

"(A) such employee was a highly compensated employee when such employee separated from service, or

"(B) such employee was a highly compensated employee at any time after attaining age 55.

"(10) COORDINATION WITH OTHER PROVISIONS.—Subsections (b), (c), (m), (n), and (o) shall be applied before the application of this section."

(b) CONFORMING AMENDMENTS.—

(1) Section 106(b)(1) is amended by striking out "highly compensated individual (within the meaning of section 105(h)(5))" and inserting in lieu thereof "highly compensated employee (within the meaning of section 414(q))".

(2) Section 117(d)(3), as amended by section 123 of this Act, is amended—

(A) by striking out "officer, owner, or",

(B) by striking out "officers, owners, or", and

(C) by inserting at the end thereof the following new sentence: "For purposes of this paragraph, the term 'highly compensated employee' has the meaning given such term by section 414(q)."

(3)(A) Section 120(c)(1) is amended by striking out "officers, shareholders, self-employed individuals, or highly compensated" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(B) Section 120(d)(1) is amended—

(i) by striking out "The term 'self-employed individual' means, and the" and inserting in lieu thereof "The", and

(ii) by striking out "SELF-EMPLOYED INDIVIDUAL;" in the heading thereof.

(4) Sections 127(b)(2) and 129(d)(2) are each amended by striking out "officers, owners, or highly compensated," and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(5)(A) Sections 132 (e)(2) and (h)(1) are each amended—

(i) by striking out "officer, owner, or", and

(ii) by striking out "officers, owners, or".

(B) Section 132(h) is amended by adding at the end thereof the following new paragraph:

"(7) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this section, the term 'highly compensated employee' has the meaning given such term by section 414(q)."

(6) Section 274(e)(5) is amended by striking out "officers, shareholders or other owners, or highly compensated employees" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(7) Section 401(a)(4) is amended to read as follows:

"(4) if the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)). For purposes of this paragraph, there shall be excluded from consideration employees described in section 410(b)(3) (A) and (C)."

(8) Section 404A(g)(1)(A) is amended by striking out "an officer, shareholder, or highly compensated" and inserting in lieu thereof "a highly compensated employee (within the meaning of section 414(q))".

(9)(A) Section 406(b)(1)(A) is amended by striking out "an officer, shareholder, or person whose principal duties consist of supervising the work of other employees of a foreign affiliate of such American employer" and insert in lieu thereof "a highly compensated employee (within the meaning of section 414(q))".

(B) Section 407(b)(1)(A) is amended by striking out "an officer, shareholder, or person whose principal duties consist of supervising the work of other employees of a domestic subsidiary" and insert in lieu thereof "a highly compensated employee (within the meaning of section 414(q))".

(C) Sections 406(b)(1)(B) and 407(b)(1)(B) are each amended by inserting "(as so defined)" after "employee".

(10) Subparagraphs (A) and (B) of section 411(d)(1) are each amended by striking out "officers, shareholders, or highly compensated" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(11) Clause (ii) of section 414(m)(2)(B) is amended by striking out "officers, highly compensated employees, or owners" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(12) Section 415(c)(3)(C)(ii) is amended by striking out "an officer, owner, or highly compensated" and inserting in lieu thereof "a highly compensated employee (within the meaning of section 414(q))".

(13) Section 423(b)(4)(D) is amended by striking out "officers, persons whose principal duties consist of supervising the work

of other employees, or highly compensated employees" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(14) Clauses (ii) and (iii) of section 501(c)(17) and subparagraphs (B) and (C) of section 501(c)(18) are each amended by striking out "officers, shareholders, persons whose principal duties consists of supervising the work of other employees, or highly compensated employees" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(15)(A) Section 4975(d)(1)(B) is amended by striking out "highly compensated employees, officers, or shareholders" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(B) Section 408(b)(1)(B) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108(b)(1)) is amended by striking out "highly compensated employees, officers, or shareholders" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q) of the Internal Revenue Code of 1986)".

(16) Paragraph (5) of section 505(b) is amended to read as follows:

"(5) HIGHLY COMPENSATED INDIVIDUAL.—For purposes of this subsection, the determination as to whether an individual is a highly compensated individual shall be made under rules similar to the rules for determining whether an individual is a highly compensated employee (within the meaning of section 414(q))."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendment made by this section shall apply to years beginning after December 31, 1986.

(2) CONFORMING AMENDMENTS TO EMPLOYEE BENEFIT PROVISIONS.—The amendments made by paragraphs (2), (3), (4), (5), and (16) of subsection (b) shall apply to years beginning after December 31, 1987.

(3) CONFORMING AMENDMENTS TO PENSION PROVISIONS.—The amendments made by paragraphs (7), (8), (9), (10), (11), (12), and (15) of subsection (b) shall apply to years beginning after December 31, 1988.

(4) SPECIAL RULE FOR DETERMINING HIGHLY COMPENSATED EMPLOYEES.—For purposes of sections 401(k) and 401(m) of the Internal Revenue Code of 1986, in the case of an employer incorporated on December 15, 1924, if more than 50 percent of its employees in the top-paid group (within the meaning of section 414(q)(4) of such Code) earn less than $25,000 (indexed at the same time and in the same manner as under section 415(d) of such Code), then the highly compensated employees shall include employees described in section 414(q)(1)(C) of such Code determined without regard to the level of compensation of such employees.

SEC. 1115. SEPARATE LINES OF BUSINESS; COMPENSATION.

(a) In General.—Section 414 is amended by adding at the end thereof the following new subsections:

"(r) Special Rules for Separate Line of Business.—

(1) In general.—For purposes of sections 89 and 410(b), an employer shall be treated as operating separate lines of business during any year if the employer for bona fide business reasons operates separate lines of business.

"(2) Line of business must have 50 employees, etc.—A line of business shall not be treated as separate under paragraph (1) unless—

"(A) such line of business has at least 50 employees who are not excluded under subsection (q)(8),

"(B) the employer notifies the Secretary that such line of business is being treated as separate for purposes of paragraph (1), and

"(C) such line of business meets guidelines prescribed by the Secretary or the employer receives a determination from the Secretary that such line of business may be treated as separate for purposes of paragraph (1).

"(3) Safe harbor rule.—The requirements of subparagraph (C) of paragraph (2) shall not apply to any line of business if the highly compensated employee percentage with respect to such line of business is—

"(A) not less than one-half, and

"(B) not more than twice,

the percentage which highly compensated employees are of all employees of the employer. An employer shall be treated as meeting the requirements of subparagraph (A) if at least 10 percent of all highly compensated employees of the employer perform services solely for such line of business.

"(4) Highly compensated employee percentage defined.—For purposes of this subsection, the term 'highly compensated employee percentage' means the percentage which highly compensated employees performing services for the line of business are of all employees performing services for the line of business.

"(5) Allocation of benefits to line of business.—For purposes of this subsection, benefits which are attributable to services provided to a line of business shall be treated as provided by such line of business.

"(6) Headquarters personnel, etc.—The Secretary shall prescribe rules providing for—

"(A) the allocation of headquarters personnel among the lines of business of the employer, and

"(B) the treatment of other employees providing services for more than 1 line of business of the employer or not in lines of business meeting the requirements of paragraph (2).

"(7) Separate operating units.—For purposes of this subsection, the term 'separate line of business' includes an operating unit in a separate geographic area separately operated for a bona fide business reason.

"(8) Affiliated service groups.—This subsection shall not apply in the case of any affiliated service group (within the meaning of section 414(m)).

"(s) Compensation.—For purposes of this part—

"(1) In general.—The term 'compensation' means compensation for service performed for an employer which (taking into account the provisions of this chapter) is currently includible in gross income.

"(2) Self-employed individuals.—The Secretary shall prescribe regulations for the determination of the compensation of an employee who is a self-employed individual (within the meaning of section 401(c)(1)) which are based on the principles of paragraph (1).

"(3) Employer may elect to treat certain deferrals as compensation.—An employer may elect to include as compensation any amount which is contributed by the employer pursuant to a salary reduction agreement and which is not includible in the gross income of an employee under section 125, 402(a)(8), 402(h), or 403(b).

"(4) Alternative determination of compensation.—The Secretary shall by regulation provide for alternative methods of determining compensation which may be used by an employer, except that such regulations shall provide that an employer may not use an alternative method if the use of such method discriminates in favor of highly compensated employees (within the meaning of subsection (q))."

(b) Effective Dates.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1986.

Subpart B—Other Provisions

SEC. 1116. CASH OR DEFERRED ARRANGEMENTS.

(a) General Rule.—Subparagraph (A) of section 401(k)(3) (relating to application of participation and discrimination standards) is amended—

(1) by striking out "1.5" in clause (ii)(I) and inserting in lieu thereof "1.25",

(2) by striking out "3 percentage points" in clause (ii)(II) and inserting in lieu thereof "2 percentage points", and

(3) by striking out "2.5" in clause (ii)(II) and inserting in lieu thereof "2".

(b) Withdrawal and Other Restrictions.—

(1) Withdrawals.—Paragraph (2)(B) of section 401(k) (defining qualified cash or deferred arrangement) is amended to read as follows:

"(B) under which—

"(i) amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election may not be distributable to participants or other beneficiaries earlier than—

"(I) separation from service, death, or disability,

"(II) termination of the plan without establishment of a successor plan,

"(III) the date of the sale by a corporation of substantially all of the assets (within the meaning of section 409(d)(2)) used by such corporation in a trade or business of such corporation with respect

to an employee who continues employment with the corporation acquiring such assets,

"(IV) the date of the sale by a corporation of such corporation's interest in a subsidiary (within the meaning of section 409(d)(3)) with respect to an employee who continues employment with such subsidiary,

"(V) in the case of a profit-sharing or stock bonus plan, the attainment of age 59½, or

"(VI) in the case of contributions to a profit-sharing or stock bonus plan to which section 402(a)(8) applies, upon hardship of the employee, and

"(ii) amounts will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years; and".

(2) NOT MORE THAN 1 YEAR OF SERVICE MAY BE REQUIRED.—Paragraph (2) of section 401(k) is amended by striking out "and" at the end of subparagraph (B), by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(D) which does not require, as a condition of participation in the arrangement, that an employee complete a period of service with the employer (or employers) maintaining the plan extending beyond the period permitted under section 410(a)(1) (determined without regard to subparagraph (B)(i) thereof)."

(3) OTHER REQUIREMENTS.—Subsection (k) of section 401 is amended by redesignating paragraphs (4), (5), and (6) as paragraphs (5), (6), and (7), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) OTHER REQUIREMENTS.—

"(A) BENEFITS (OTHER THAN MATCHING CONTRIBUTIONS) MUST NOT BE CONTINGENT ON ELECTION TO DEFER.—A cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement if any other benefit provided by such employer is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election.

"(B) STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS NOT ELIGIBLE.—A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by—

"(i) a State or local government or political subdivision thereof, or any agency or instrumentality thereof, or

"(ii) any organization exempt from tax under this subtitle.

"(C) COORDINATION WITH OTHER PLANS.—Except as provided in section 401(m), any employer contribution made

pursuant to an employee's election under a qualified cash or deferred arrangement shall not be taken into account for purposes of determining whether any other plan meets the requirements of section 401(a) or 410(b). This subparagraph shall not apply for purposes of determining whether a plan meets the average benefit requirement of section 410(b)(2)(A)(ii)."

(4) AGGREGATION RULE.—The last sentence of subparagraph (A) of section 401(k)(3) (relating to application of participation and discrimination standards) is amended by striking out "any employee" and inserting in lieu thereof "any highly compensated employee".

(c) PLAN NOT DISQUALIFIED IF EXCESS CONTRIBUTIONS DISTRIBUTED BEFORE THE END OF FOLLOWING PLAN YEAR.—

(1) IN GENERAL.—Subsection (k) of section 401 is amended by adding at the end thereof the following new paragraph:

"(8) ARRANGEMENT NOT DISQUALIFIED IF EXCESS CONTRIBUTIONS DISTRIBUTED.—

"(A) IN GENERAL.—A cash or deferred arrangement shall not be treated as failing to meet the requirements of clause (ii) of paragraph (3)(A) for any plan year if, before the close of the following plan year—

"(i) the amount of the excess contributions for such plan year (and any income allocable to such contributions) is distributed, or

"(ii) to the extent provided in regulations, the employee elects to treat the amount of the excess contributions as an amount distributed to the employee and then contributed by the employee to the plan.

Any distribution of excess contributions (and income) may be made without regard to any other provision of law.

"(B) EXCESS CONTRIBUTIONS.—For purposes of subpara graph (A), the term 'excess contributions' means, with re spect to any plan year, the excess of—

"(i) the aggregate amount of employer contribution actually paid over to the trust on behalf of highly com pensated employees for such plan year, over

"(ii) the maximum amount of such contributions per mitted under the limitations of clause (ii) of paragraph (3)(A) (determined by reducing contributions made o behalf of highly compensated employees in order of th actual deferral percentages beginning with the highes of such percentages).

"(C) METHOD OF DISTRIBUTING EXCESS CONTRIBUTIONS.— Any distribution of the excess contributions for any pla year shall be made to highly compensated employees on th basis of the respective portions of the excess contribution attributable to each of such employees.

"(D) ADDITIONAL TAX UNDER SECTION 72(t) NOT T APPLY.—No tax shall be imposed under section 72(t) on an amount required to be distributed under this paragraph.

"(E) CROSS REFERENCE.—

"For excise tax on certain excess contributions, see section 4979."

(2) Technical amendment.—Clause (ii) of section 401(k)(3)(A) is amended by striking out "paragraph (4)" and inserting in lieu thereof "paragraph (5)".

(d) Definitions of Highly Compensated Employee and Compensation.—

(1) Highly compensated employee.—Paragraph (5) of section 401(k), as redesignated by this Act, is amended to read as follows:

"(5) Highly compensated employee.—For purposes of this subsection, the term 'highly compensated employee' has the meaning given such term by section 414(q)."

(2) Compensation.—Section 401(k), as amended by this Act, is amended by adding at the end thereof the following new paragraph:

"(9) Compensation.—For purposes of this subsection, the term 'compensation' has the meaning given such term by section 414(s)."

(3) Conforming amendment.—Subparagraph (B) of section 401(k)(3) is amended by striking out the last sentence thereof.

(e) Nondiscrimination Standards.—Section 401(k)(3) is amended by adding at the end thereof the following new subparagraph:

"(C) For purposes of subparagraph (B), the employer contributions on behalf of any employee—

"(i) shall include any employer contributions made pursuant to the employee's election under paragraph (2), and

"(ii) under such rules as the Secretary may prescribe, may, at the election of the employer, include—

"(I) matching contributions (as defined in 401(m)(4)(A) which meets the requirements of paragraph (2) (B and (C)), and

"(II) qualified nonelective contributions (within the meaning of section 401(m)(4)(C))."

(f) Effective Dates.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to years beginning after December 31, 1988.

(2) Nondiscrimination rules.—

(A) In general.—Except as provided in subparagraph (B), the amendments made by subsections (a), (b)(4), and (d), and the provisions of section 401(k)(4)(B) of the Internal Revenue Code of 1986 (as added by this section), shall apply to years beginning after December 31, 1986.

(B) Transition rules for certain governmental and tax-exempt plans.—Subparagraph (B) of section 401(k)(4) of the Internal Revenue Code of 1986 (relating to governments and tax-exempt organizations not eligible for cash or deferred arrangements), as added by this section, shall not apply to any cash or deferred arrangement adopted by—

(i) a State or local government (or political subdivision thereof) before May 6, 1986, or

(ii) a tax-exempt organization before July 2, 1986.

In the case of an arrangement described in clause (i), the amendments made by subsections (a), (b)(4), and (d) shall apply to years beginning after December 31, 1988.

(3) Aggregation and excess contributions.—The amendments made by subsections (c) and (e) shall apply to years beginning after December 31, 1986.

(4) Collective bargaining agreements.—

(A) In general.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to years beginning before the earlier of—

(i) the later of—

(I) January 1, 1989, or

(II) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(ii) January 1, 1991.

(B) Special rule for nondiscrimination rules.—In the case of a plan described in subparagraph (A), the amendments and provisions described in paragraph (2) shall not apply to years beginning before the earlier of—

(i) the date determined under subparagraph (A)(i)(II), or

(ii) January 1, 1989.

(5) Special rule for qualified offset arrangements.—

(A) In general.—A cash or deferred arrangement shall not be treated as failing to meet the requirements of section 401(k)(4) of the Internal Revenue Code of 1986 (as added by this section) to the extent such arrangement is part of a qualified offset arrangement consisting of such cash or deferred arrangement and a defined benefit plan.

(B) Qualified offset arrangement.—For purposes of subparagraph (A), a cash or deferred arrangement is part of a qualified offset arrangement with a defined benefit plan to the extent such offset arrangement satisfies each of the following conditions with respect to the employer maintaining the arrangement on April 16, 1986, and at all times thereafter:

(i) The benefit under the defined benefit plan is directly and uniformly conditioned on the initial elective deferrals (up to 4 percent of compensation).

(ii) The benefit provided under the defined benefit plan (before the offset) is at least 60 percent of an employee's cumulative elective deferrals (up to 4 percent of compensation).

(iii) The benefit under the defined benefit plan is reduced by the benefit attributable to the employee's elective deferrals under the plan (up to 4 percent of compensation) and the income allocable thereto. The interest rate used to calculate the reduction shall not exceed the greater of the rate under section 411(a)(11)(B)(ii) of such Code or the interest rate applicable under section

411(c)(2)(C)(iii) of such Code, taking into account section 411(c)(2)(D) of such Code.

For purposes of applying section 401(k)(3) of such Code to the cash or deferred arrangement, the benefits under the defined benefit plan conditioned on initial elective deferrals may be treated as matching contributions under such rules as the Secretary of the Treasury or his delegate may prescribe. The Secretary shall provide rules for the application of this paragraph in the case of successor plans.

(C) DEFINITION OF EMPLOYER.—For purposes of this paragraph, the term "employer" includes any research and development center which is federally funded and engaged in cancer research, but only with respect to employees of contractor-operators whose salaries are reimbursed as direct costs against the operator's contract to perform work at such center.

(6) WITHDRAWALS ON SALE OF ASSETS.—Subclauses (II), (III), and (IV) of section 401(k)(2)(B)(i) of the Internal Revenue Code of 1986 (as added by subsection (b)(1)) shall apply to distributions after December 31, 1984.

(7) DISTRIBUTIONS BEFORE PLAN AMENDMENT.—

(A) IN GENERAL.—If a plan amendment is required to allow a plan to make any distribution described in section 401(k)(8) of the Internal Revenue Code of 1986, any such distribution which is made before the close of the 1st plan year for which such amendment is required to be in effect under section 1140, shall be treated as made in accordance with the provisions of such plan.

(B) DISTRIBUTIONS PURSUANT TO MODEL AMENDMENT.—

(i) SECRETARY TO PRESCRIBE AMENDMENT.—The Secretary of the Treasury or his delegate shall prescribe an amendment which allows a plan to make any distribution described in section 401(k)(8) of such Code.

(ii) ADOPTION BY PLAN.—If a plan adopts the amendment prescribed under clause (i) and makes a distribution in accordance with such amendment, such distribution shall be treated as made in accordance with the provisions of the plan.

SEC. 1117. NONDISCRIMINATION REQUIREMENTS FOR EMPLOYER MATCHING CONTRIBUTIONS AND EMPLOYEE CONTRIBUTIONS.

(a) GENERAL RULE.—Section 401 (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by redesignating subsections (m) and (n) as subsections (n) and (o), respectively, and by inserting after subsection (l) the following new subsection:

"(m) NONDISCRIMINATION TEST FOR MATCHING CONTRIBUTIONS AND EMPLOYEE CONTRIBUTIONS.—

"(1) IN GENERAL.—A plan shall be treated as meeting the requirements of subsection (a)(4) with respect to the amount of any matching contribution or employee contribution for any plan year only if the contribution percentage requirement of paragraph (2) of this subsection is met for such plan year.

"(2) REQUIREMENTS.—

"(A) Contribution percentage requirement.—A plan meets the contribution percentage requirement of this paragraph for any plan year only if the contribution percentage for eligible highly compensated employees does not exceed the greater of—

"(i) 125 percent of such percentage for all other eligible employees, or

"(ii) the lesser of 200 percent of such percentage for all other eligible employees, or such percentage for all other eligible employees plus 2 percentage points.

"(B) Multiple plans treated as a single plan.—If two or more plans of an employer to which matching contributions, employee contributions, or elective deferrals are made are treated as one plan for purposes of section 410(b), such plans shall be treated as one plan for purposes of this subsection. If a highly compensated employee participates in two or more plans of an employer to which such contributions are made, all such contributions shall be aggregated for purposes of this subsection.

"(3) Contribution percentage.—For purposes of paragraph (2), the contribution percentage for a specified group of employees for a plan year shall be the average of the ratios (calculated separately for each employee in such group) of—

"(A) the sum of the matching contributions and employee contributions paid under the plan on behalf of each such employee for such plan year, to

"(B) the employee's compensation (within the meaning of section 414(s)) for such plan year.

Under regulations, an employer may elect to take into account (in computing the contribution percentage) elective deferrals and qualified nonelective contributions under the plan or any other plan of the employer.

"(4) Definitions.—For purposes of this subsection—

"(A) Matching contribution.—The term 'matching contribution' means—

"(i) any employer contribution made to the plan on behalf of an employee on account of an employee contribution made by such employee, and

"(ii) any employer contribution made to the plan on behalf of an employee on account of an employee's elective deferral.

"(B) Elective deferral.—The term 'elective deferral' means any employer contribution described in section 402(g)(3)(A).

"(C) Qualified nonelective contributions.—The term 'qualified nonelective contribution' means any employer contribution (other than a matching contribution) with respect to which—

"(i) the employee may not elect to have the contribution paid to the employee in cash instead of being contributed to the plan, and

"(ii) the requirements of subparagraphs (B) and (C) of subsection (k)(2) are met.

"(5) Employees taken into consideration.—

"(A) IN GENERAL.—Any employee who is eligible to make an employee contribution (or, if the employer takes elective contributions into account, elective contributions) or to receive a matching contribution under the plan being tested under paragraph (1) shall be considered an eligible employee for purposes of this subsection.

"(B) CERTAIN NONPARTICIPANTS.—If an employee contribution is required as a condition of participation in the plan, any employee who would be a participant in the plan if such employee made such a contribution shall be treated as an eligible employee on behalf of whom no employer contributions are made.

"(6) PLAN NOT DISQUALIFIED IF EXCESS AGGREGATE CONTRIBUTIONS DISTRIBUTED BEFORE END OF FOLLOWING PLAN YEAR.—

"(A) IN GENERAL.—A plan shall not be treated as failing to meet the requirements of paragraph (1) for any plan year if, before the close of the following plan year, the amount of the excess aggregate contributions for such plan year (and any income allocable to such contributions) is distributed (or, if forfeitable, is forfeited). Such contributions (and such income) may be distributed without regard to any other provision of law.

"(B) EXCESS AGGREGATE CONTRIBUTIONS.—For purposes of subparagraph (A), the term 'excess aggregate contributions' means, with respect to any plan year, the excess of—

"(i) the aggregate amount of the matching contributions and employee contributions (and any qualified nonelective contribution or elective contribution taken into account in computing the contribution percentage) actually made on behalf of highly compensated employees for such plan year, over

"(ii) the maximum amount of such contributions permitted under the limitations of paragraph (2)(A) (determined by reducing contributions made on behalf of highly compensated employees in order of their contribution percentages beginning with the highest of such percentages).

"(C) METHOD OF DISTRIBUTING EXCESS CONTRIBUTIONS.—Any distribution of the excess aggregate contributions for any plan year shall be made to highly compensated employees on the basis of the respective portions of such amounts attributable to each of such employees. Forfeitures of excess aggregate contributions may not be allocated to participants whose contributions are reduced under this paragraph.

"(D) COORDINATION WITH SUBSECTION (k) AND 402(g).—The determination of the amount of excess aggregate contributions with respect to a plan shall be made after—

"(i) first determining the excess deferrals (within the meaning of section 402(g)), and

"(ii) then determining the excess contributions under subsection (k).

"(7) TREATMENT OF DISTRIBUTIONS.—

"(A) ADDITIONAL TAX OF SECTION 72(t) NOT APPLICABLE.—No tax shall be imposed under section 72(t) on any amount required to be distributed under paragraph (8).

"(B) EXCLUSION OF EMPLOYEE CONTRIBUTIONS.—Any distribution attributable to employee contributions shall not be included in gross income except to the extent attributable to income on such contributions.

"(8) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this subsection, the term 'highly compensated employee' has the meaning given to such term by section 414(q).

"(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k) including—

"(A) such regulations as may be necessary to prevent the multiple use of the alternative limitation with respect to any highly compensated employee, and

"(B) regulations permitting appropriate aggregation of plans and contributions.

For purposes of the preceding sentence, the term 'alternative limitation' means the limitation of section 401(k)(3)(A)(ii)(II) and the limitation of paragraph (2)(A)(ii) of this subsection.

"(10) CROSS REFERENCE.—

"For excise tax on certain excess contributions, see section 4979."

(b) EXCISE TAX ON EXCESS CONTRIBUTIONS.—

(1) IN GENERAL.—Chapter 43 (relating to qualified pension, etc. plans) is amended by adding at the end thereof the following new section:

"SEC. 4979. TAX ON CERTAIN EXCESS CONTRIBUTIONS.

"(a) GENERAL RULE.—In the case of any plan, there is hereby imposed a tax for the taxable year equal to 10 percent of the sum of—

"(1) any excess contributions under a cash or deferred arrangement which is part of such plan for the plan year ending in such taxable year, and

"(2) any excess aggregate contributions under the plan for the plan year ending in such taxable year.

"(b) LIABILITY FOR TAX.—The tax imposed by subsection (a) shall be paid by the employer.

"(c) EXCESS CONTRIBUTIONS.—For purposes of this section, the term 'excess contributions' has the meaning given such term by sections 401(k)(8)(B), 403(b), 408(k)(8)(B), and 501(c)(18).

"(d) EXCESS AGGREGATE CONTRIBUTION.—For purposes of this section, the term 'excess aggregate contribution' has the meaning given to such term by section 401(m)(6)(B).

"(e) PLAN.—For purposes of this section, the term 'plan' means—

"(1) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(2) any annuity plan described in section 403(a),

"(3) any annuity contract described in section 403(b),

"(4) a simplified employee pension of an employer which satisfies the requirements of section 408(k), and

"(5) a plan described in section 501(c)(18).

Such term includes any plan which, at any time, has been determined by the Secretary to be such a plan.

"(f) No Tax Where Excess Distributed Within 2½ Months of Close of Year.—

"(1) In general.—No tax shall be imposed under this section on any excess contribution or excess aggregate contribution, as the case may be, to the extent such contribution (together with any income allocable thereto) is distributed (or, if forfeitable, is forfeited) before the close of the first 2½ months of the following plan year.

"(2) Included in prior year.—Any amount distributed as provided in paragraph (1) shall be treated as received and earned by the recipient in his taxable year for which such contribution was made."

(2) Clerical amendment.—The table of sections for chapter 43 is amended by adding at the end thereof the following new item:

"Sec. 4979. Tax on certain excess contributions."

(c) Technical Amendment.—Paragraph (2) of section 414(k) (relating to certain plans) is amended by striking out "and 415 (relating to limitations on benefits and contributions under qualified plans)" and inserting in lieu thereof ", 415 (relating to limitations on benefits and contributions under qualified plans), and 401(m) (relating to nondiscrimination tests for matching requirements and employee contributions)".

(d) Effective Date.—

(1) In general.—The amendments made by this section shall apply to plan years beginning after December 31, 1986.

(2) Collective bargaining agreements.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to plan years beginning before the earlier of—

(A) January 1, 1989, or

(B) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986).

(3) Annuity contracts.—In the case of an annuity contract under section 403(b) of the Internal Revenue Code of 1986—

(A) the amendments made by this section shall apply to plan years beginning after December 31, 1988, and

(B) in the case of a collective bargaining agreement described in paragraph (2), the amendments made by this section shall not apply to years beginning before the earlier of—

(i) the later of—

(I) January 1, 1989, or

(II) the date determined under paragraph (2)(B), or

(ii) January 1, 1991.

SEC. 1118. BENEFITS TREATED AS ACCRUING RATABLY FOR PURPOSES OF DETERMINING WHETHER PLAN IS TOP-HEAVY.

(a) GENERAL RULE.—Paragraph (4) of section 416(g) (defining top-heavy plan) is amended by adding at the end thereof the following new subparagraph:

"(F) ACCRUED BENEFITS TREATED AS ACCRUING RATABLY.—The accrued benefit of any employee (other than a key employee) shall be determined—

"(i) under the method which is used for accrual purposes for all plans of the employer, or

"(ii) if there is no method described in clause (i), as if such benefit accrued not more rapidly than the slowest accrual rate permitted under section 411(b)(1)(C)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to plan years beginning after December 31, 1986.

SEC. 1119. MODIFICATION OF RULES FOR BENEFIT FORFEITURES.

(a) GENERAL RULE.—Paragraph (8) of section 401(a) (relating to qualified pension, profit-sharing, and stock bonus plans) is amended by striking out "pension plan" and inserting in lieu thereof "defined benefit plan".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to plan years beginning after December 31, 1985.

SEC. 1120. NONDISCRIMINATION REQUIREMENTS FOR TAX-SHELTERED ANNUITIES.

(a) GENERAL RULE.—Paragraph (1) of section 403(b) is amended by striking out "and" at the end of subparagraph (B), by inserting "and" at the end of subparagraph (C), and by inserting after subparagraph (C) the following new subparagraph:

"(D) except in the case of a contract purchased by a church, such contract is purchased under a plan which meets the nondiscrimination requirements of paragraph (10),".

(b) NONDISCRIMINATION REQUIREMENTS.—Subsection (b) of section 403 is amended by adding at the end thereof the following new paragraph:

"(10) NONDISCRIMINATION REQUIREMENTS.—

"(A) IN GENERAL.—For purposes of paragraph (1)(D), a plan meets the nondiscrimination requirements of this paragraph if—

"(i) with respect to contributions not made pursuant to a salary reduction agreement, such plan meets the requirements of paragraphs (4), (5), and (26) of section 401(a) and section 410(b) in the same manner as if such plan were described in section 401(a), and

"(ii) all employees of the organization may elect to have the employer make contributions of more than $200 pursuant to a salary reduction agreement if any employee of the organization may elect to have the organization make contributions for such contracts pursuant to such agreement.

For purposes of clause (ii), there may be excluded any employee who is a participant in an eligible deferred compensation plan (within the meaning of section 457) or a quali-

fied cash or deferred arrangement of the organization or another annuity contract described in this subsection. Any nonresident alien described in section 410(b)(3)(C) may also be excluded. For purposes of this subparagraph, students who normally work less than 20 hours per week may (subject to the conditions applicable under section 410(b)(4)) be excluded.

"(B) Church.—For purposes of paragraph (1)(D), the term 'church' has the meaning given to such term by section 3121(w)(3)(A). Such term shall include any qualified church-controlled organization (as defined in section 3121(w)(3)(B))."

(c) Effective Date.—The amendments made by this section shall apply to years beginning after December 31, 1988.

PART III—TREATMENT OF DISTRIBUTIONS

SEC. 1121. MINIMUM DISTRIBUTION REQUIREMENTS.

(a) Excise Tax on Failure To Distribute.—

(1) In general.—Section 4974 is amended to read as follows:

"SEC. 4974. EXCISE TAX ON CERTAIN ACCUMULATIONS IN QUALIFIED RETIREMENT PLANS.

"(a) General Rule.—If the amount distributed during the taxable year of the payee under any qualified retirement plan or any eligible deferred compensation plan (as defined in section 457(b)) is less than the minimum required distribution for such taxable year, there is hereby imposed a tax equal to 50 percent of the amount by which such minimum required distribution exceeds the actual amount distributed during the taxable year. The tax imposed by this section shall be paid by the payee.

"(b) Minimum Required Distribution.—For purposes of this section, the term 'minimum required distribution' means the minimum amount required to be distributed during a taxable year under section 401(a)(9), 403(b)(10), 408(a)(6), 408(b)(3), or 457(d)(2), as the case may be, as determined under regulations prescribed by the Secretary.

"(c) Qualified Retirement Plan.—For purposes of this section, the term 'qualified retirement plan' means—

"(1) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(2) an annuity plan described in section 403(a),

"(3) an annuity contract described in section 403(b),

"(4) an individual retirement account described in section 408(a), or

"(5) an individual retirement annuity described in section 408(b).

Such term includes any plan, contract, account, or annuity which, at any time, has been determined by the Secretary to be such a plan, contract, account, or annuity.

"(d) Waiver of Tax in Certain Cases.—If the taxpayer establishes to the satisfaction of the Secretary that—

"(1) the shortfall described in subsection (a) in the amount distributed during any taxable year was due to reasonable error, and

"(2) reasonable steps are being taken to remedy the shortfall,

the Secretary may waive the tax imposed by subsection (a) for the taxable year."

(2) Clerical amendment.—The table of sections for chapter 43 is amended by striking out the item relating to section 4974 and inserting in lieu thereof the following:

"Sec. 4974. Excise tax on certain accumulations in qualified retirement plans."

(b) Uniform Required Beginning Date.—Subparagraph (C) of section 401(a)(9) (defining required beginning date) is amended to read as follows:

"(C) Required beginning date.—For purposes of this paragraph, the term 'required beginning date' means April 1 of the calendar year following the calendar year in which the employee attains age 70½."

(c) Conforming Amendments.—

(1) Subparagraph (F) of section 402(a)(5) is amended to read as follows:

"(F) Transfer treated as rollover contribution under section 408.—For purposes of this title, a transfer described in subparagraph (A) to an eligible retirement plan described in subclause (I) or (II) of subparagraph (E)(iv) shall be treated as a rollover contribution described in section 408(d)(3)."

(2) Clause (ii) of section 408(d)(3)(A) is amended by striking out the third and fourth parenthetical phrases.

(d) Effective Dates.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to years beginning after December 31, 1988.

(2) Subsection (c).—The amendments made by subsection (c) shall apply to years beginning after December 31, 1986.

(3) Collective bargaining agreements.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to distributions to individuals covered by such agreements in plan years beginning before the earlier of—

(A) the later of—

(i) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(ii) January 1, 1989, or

(B) January 1, 1991.

(4) Transition rules.—

(A) The amendments made by subsections (a) and (b) shall not apply with respect to any benefits with respect to which a designation is in effect under section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act of 1982.

(B)(i) Except as provided in clause (ii), the amendment made by subsection (b) shall not apply in the case of any

individual who has attained age 70½ before January 1, 1988.

(ii) Clause (i) shall not apply to any individual who is a 5-percent owner (as defined in section 416(i) of the Internal Revenue Code of 1986), at any time during—

(I) the plan year ending with or within the calendar year in which such owner attains age 66½, and

(II) any subsequent plan year.

SEC. 1122. TAXATION OF DISTRIBUTIONS.

(a) Limitations on Special Averaging Provisions.—

(1) Averaging provisions limited to 1 lump sum distribution after age 59½.—Subparagraph (B) of section 402(e)(4) (relating to election of lump sum treatment) is amended to read as follows:

"(B) Averaging to apply to 1 lump sum distribution after age 59½. —Paragraph (1) shall apply to a lump sum distribution with respect to an employee under subparagraph (A) only if—

"(i) such amount is received on or after the taxpayer has attained age 59½, and

"(ii) the taxpayer elects for the taxable year to have all such amounts received during such taxable year so treated.

Not more than 1 election may be made under this subparagraph by any taxpayer with respect to any employee. No election may be made under this subparagraph by any taxpayer other than an individual, an estate, or a trust. In the case of a lump sum distribution made with respect to an employee to 2 or more trusts, the election under this subparagraph shall be made by the personal representative of the taxpayer."

(2) 5-year averaging in lieu of 10-year averaging.—Subparagraph (C) of section 402(e)(1) (relating to initial separate tax) is amended—

(A) by striking out "10 times" and inserting in lieu thereof "5 times", and

(B) by striking out "one-tenth" and inserting in lieu thereof "⅕".

(b) Repeal of Capital Gains Treatment.—

(1) In general.—The following provisions are hereby repealed:

(A) Paragraph (2) of section 402(a) (relating to capital gains treatment for portion of lump sum distribution).

(B) Paragraph (2) of section 403(a) (relating to capital gains treatment for certain distributions).

(2) Technical amendments.—

(A) Clause (iii) of section 402(a)(5)(D) is amended to read as follows:

"(iii) Denial of 10-year averaging for subsequent distributions.—If an election under clause (i) is made with respect to any partial distribution paid to any employee, paragraphs (1) and (3) of subsection (e) shall not apply to any distribution (paid after such partial dis-

tribution) of the balance to the credit of such employee under the plan under which such partial distribution was made (or under any other plan which, under subsection (e)(4)(C), would be aggregated with such plan)."

(B) Paragraph (1) of section 402(e) is amended—

(i) by striking out subparagraph (B) and by redesignating subparagraphs (C), (D), and (E) as subparagraphs (B), (C), and (D), respectively, and

(ii) by striking out "The initial separate tax" in subparagraph (B) (as so redesignated) and inserting in lieu thereof "The amount of tax imposed by subparagraph (A)", and

(iii) by striking out "INITIAL SEPARATE" in the heading of subparagraph (B) (as so redesignated) and inserting in lieu thereof "AMOUNT OF TAX".

(C) Paragraph (3) of section 402(e) is amended by striking out "the ordinary income portion" and inserting in lieu thereof "total taxable amount".

(D) Paragraph (4) of section 402(e) is amended by striking out subparagraph (E).

(E) Subparagraph (H) of section 402(e)(4) is amended by striking out "(but not for purposes of subsection (a)(2) or section 403(a)(2)(A))".

(c) AMENDMENTS TO SECTION 72.—

(1) REPEAL OF SPECIAL RULE FOR EMPLOYEES' ANNUITIES.—Subsection (d) of section 72 (relating to employee's annuities where employee's contributions recoverable in 3 years) is hereby repealed.

(2) AMOUNT EXCLUDED UNDER EXCLUSION RATIO LIMITED TO EMPLOYEE'S INVESTMENT IN THE CONTRACT.—Subsection (b) of section 72 (relating to exclusion ratio) is amended to read as follows:

"(b) EXCLUSION RATIO.—

"(1) IN GENERAL.—Gross income does not include that part of any amount received as an annuity under an annuity, endowment, or life insurance contract which bears the same ratio to such amount as the investment in the contract (as of the annuity starting date) bears to the expected return under the contract (as of such date).

"(2) EXCLUSION LIMITED TO INVESTMENT.—The portion of any amount received as an annuity which is excluded from gross income under paragraph (1) shall not exceed the unrecovered investment in the contract immediately before the receipt of such amount.

"(3) DEDUCTION WHERE ANNUITY PAYMENTS CEASE BEFORE ENTIRE INVESTMENT RECOVERED.—

"(A) IN GENERAL.—If—

"(i) after the annuity starting date, payments as an annuity under the contract cease by reason of the death of an annuitant, and

"(ii) as of the date of such cessation, there is unrecovered investment in the contract,

the amount of such unrecovered investment (in excess of any amount specified in subsection (e)(5) which was not in-

cluded in gross income) shall be allowed as a deduction to the annuitant for his last taxable year.

"(B) PAYMENTS TO OTHER PERSONS.—In the case of any contract which provides for payments meeting the requirements of subparagraphs (B) and (C) of subsection (c)(2), the deduction under subparagraph (A) shall be allowed to the person entitled to such payments for the taxable year in which such payments are received.

"(C) NET OPERATING LOSS DEDUCTIONS PROVIDED.—For purposes of section 172, a deduction allowed under this paragraph shall be treated as if it were attributable to a trade or business of the taxpayer.

"(4) UNRECOVERED INVESTMENT.—For purposes of this subsection, the unrecovered investment in the contract as of any date is—

"(A) the investment in the contract as of the annuity starting date, reduced by

"(B) the aggregate amount received under the contract on or after such annuity starting date and before the date as of which the determination is being made, to the extent such amount was excludable from gross income under this subtitle."

(3) AMOUNTS NOT RECEIVED AS ANNUITIES ALLOCATED ON A PRO RATA BASIS.—

(A) IN GENERAL.—Subsection (e) of section 72 is amended by adding at the end thereof the following new paragraphs:

"(8) EXTENSION OF PARAGRAPH (2)(B) TO QUALIFIED PLANS.—

"(A) IN GENERAL.—Notwithstanding any other provision of this subsection (other than paragraph (7)), in the case of any amount received before the annuity starting date from a trust or contract described in paragraph (5)(D), paragraph (2)(B) shall apply to such amounts.

"(B) ALLOCATION OF AMOUNT RECEIVED.—For purposes of paragraph (2)(B), the amount allocated to the investment in the contract shall be the portion of the amount described in subparagraph (A) which bears the same ratio to such amount as the investment in the contract bears to the account balance. The determination under the preceding sentence shall be made as of the time of the distribution or at such other time as the Secretary may prescribe.

"(C) TREATMENT OF FORFEITABLE RIGHTS.—If an employee does not have a nonforfeitable right to any amount under any trust or contract to which subparagraph (A) applies, such amount shall not be treated as part of the account balance.

"(D) INVESTMENT IN THE CONTRACT BEFORE 1987.—In the case of a plan which on May 5, 1986, permitted withdrawal of any employee contributions before separation from service, subparagraph (A) shall apply only to the extent that amounts received before the annuity starting date (when increased by amounts previously received under the contract after December 31, 1986) exceed the investment in the contract as of December 31, 1986.

"(9) TREATMENT OF EMPLOYEE CONTRIBUTIONS AS SEPARATE CONTRACT.—Any employee contributions (and any income allocable thereto) under a defined contribution plan shall be treated as a separate contract for purposes of this subsection."

(B) CONFORMING AMENDMENT.—Subparagraph (D) of section 72(e)(5) is amended by striking out "paragraph (7)" and inserting in lieu thereof "paragraphs (7) and (8)".

(d) BENEFICIARY OF QUALIFIED ANNUITIES TAXED ONLY WHEN AMOUNTS ACTUALLY RECEIVED.—

(1) Paragraph (1) of section 403(a) (relating to taxability of beneficiary under a qualified annuity plan) is amended to read as follows:

"(1) DISTRIBUTEE TAXABLE UNDER SECTION 72.—If an annuity contract is purchased by an employer for an employee under a plan which meets the requirements of section 404(a)(2) (whether or not the employer deducts the amounts paid for the contract under such section), the amount actually distributed to any distributee under the contract shall be taxable to the distributee (in the year in which so distributed) under section 72 (relating to annuities)."

(2) The second sentence of section 403(b)(1) (relating to taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school) is amended to read as follows: "The amount actually distributed to any distributee under such contract shall be taxable to the distributee (in the year in which so distributed) under section 72 (relating to annuities)."

(3) The last sentence of section 403(c) (relating to taxability of beneficiary under nonqualified annuities or under annuities purchased by exempt organizations) is amended to read as follows: "In the case of any portion of any contract which is attributable to premiums to which this subsection applies, the amount actually paid or made available under such contract to any beneficiary which is attributable to such premiums shall be taxable to the beneficiary (in the year in which so paid or made available) under section 72 (relating to annuities)."

(e) SPECIAL RULES FOR ROLLOVER DISTRIBUTIONS.—

(1) PARTIAL ROLLOVERS.—Clause (i) of section 402(a)(5)(D) (relating to requirements for partial distributions) is amended to read as follows:

"(i) REQUIREMENTS.—Subparagraph (A) shall apply to a partial distribution only if the employee elects to have subparagraph (A) apply to such distribution and such distribution would be a lump sum distribution if subsection (e)(4)(A) were applied—

"(I) by substituting '50 percent of the balance to the credit of an employee' for 'the balance to the credit of an employee',

"(II) without regard to clause (ii) thereof, the second sentence thereof, and subparagraph (B) of subsection (e)(4).

Any distribution described in section 401(a)(28)(B)(ii) shall be treated as meeting the requirements of this clause."

(2) Extension of rollover period for frozen deposits.—

(A) In general.—Section 402(a)(6) (relating to special rollover rules) is amended by adding at the end thereof the following new subparagraph:

"(H) Special rule for frozen deposits.—

"(i) In general.—The 60-day period described in paragraph (5)(C) shall not—

"(I) include any period during which the amount transferred to the employee is a frozen deposit, or

"(II) end earlier than 10 days after such amount ceases to be a frozen deposit.

"(ii) Frozen deposit.—For purposes of this subparagraph, the term 'frozen deposit' means any deposit which may not be withdrawn because of—

"(I) the bankruptcy or insolvency of any financial institution, or

"(II) any requirement imposed by the State in which such institution is located by reason of the bankruptcy or insolvency (or threat thereof) of 1 or more financial institutions in such State."

(B) Individual retirement plans.—Section 408(d)(3) (relating to rollover contribution) is amended by adding at the end thereof the following new subparagraph:

"(F) Frozen deposits.—For purposes of this paragraph, rules similar to the rules of section 402(a)(6)(H) (relating to frozen deposits) shall apply."

(g) Net Unrealized Appreciation.—Section 402(e)(4)(J) (relating to unrealized appreciation of employer securities) is amended by adding at the end thereof the following new sentence: "To the extent provided by the Secretary, a taxpayer may elect before any distribution not to have this paragraph apply with respect to such distribution."

(h) Effective Dates.—

(1) In general.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to amounts distributed after December 31, 1986, in taxable years ending after such date.

(2) Subsection (c).—

(A) Subsection (c)(1).—The amendment made by subsection (c)(1) shall apply to individuals whose annuity starting date is after July 1, 1986.

(B) Subsection (c)(2).—The amendment made by subsection (c)(2) shall apply to individuals whose annuity starting date is after December 31, 1986.

(C) Special rule for amounts not received as annuities.—In the case of any plan not described in section 72(e)(8)(D) of the Internal Revenue Code of 1986 (as added by subsection (c)(3)), the amendments made by subsection (c)(3) shall apply to amounts received after July 1, 1986.

(3) Special rule for individuals who attained age 50 before January 1, 1986.—

(A) In general.—In the case of a lump sum distribution to which this paragraph applies—

(i) the existing capital gains provisions shall continue to apply, and

(ii) the requirement of subparagraph (B) of section 402(e)(4) of the Internal Revenue Code of 1986 (as amended by subsection (a)) that the distribution be received after attaining age 59½ shall not apply.

(B) COMPUTATION OF TAX.—If subparagraph (A) applies to any lump sum distribution of any taxpayer for any taxable year, the tax imposed by section 1 of the Internal Revenue Code of 1986 on such taxpayer for such taxable year shall be equal to the sum of—

(i) the tax imposed by such section 1 on the taxable income of the taxpayer (reduced by the portion of such lump sum distribution to which clause (ii) applies), plus

(ii) 20 percent of the portion of such lump sum distribution to which the existing capital gains provisions continue to apply by reason of this paragraph.

(C) LUMP SUM DISTRIBUTIONS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply to any lump sum distribution if—

(i) such lump sum distribution is received by an individual who has attained age 50 before January 1, 1986, and

(ii) the taxpayer makes an election under this paragraph.

Not more than 1 election may be made under this paragraph with respect to an employee. An election under this subparagraph shall be treated as an election under section 402(e)(4)(B) of such Code with respect to any other lump sum distribution.

(4) 5-YEAR PHASE-OUT OF CAPITAL GAINS TREATMENT.—

(A) Notwithstanding the amendment made by subsection (b), if the taxpayer elects the application of this paragraph with respect to any distribution after December 31, 1986, and before January 1, 1992, the phase-out percentage of the amount which would have been treated, without regard to this subparagraph, as long-term capital gain under the existing capital gains provisions shall be treated as long-term capital gain.

(B) For purposes of this paragraph—

In the case of distributions during calendar year:	The phase-out percentage is:
1987	100
1988	95
1989	75
1990	50
1991	25.

(C) No more than 1 election may be made under this paragraph with respect to an employee. An election under this paragraph shall be treated as an election under section 402(e)(4)(B) of the Internal Revenue Code of 1986 with respect to any other lump sum distribution.

(5) Election of 10-year averaging.—An individual who has attained age 50 before January 1, 1986, and elects the application of paragraph (3) or section 402(e)(1) of the Internal Revenue Code of 1986 (as amended by this Act) may elect to have such section applied by substituting "10 times" for "5 times" and "1/10" for "1/5" in subparagraph (B) thereof. For purposes of the preceding sentence, section 402(e)(1) of such Code shall be applied by using the rate of tax in effect under section 1 of the Internal Revenue Code of 1954 for taxable years beginning during 1986.

(6) Existing capital gain provisions.—For purposes of paragraphs (3) and (4), the term 'existing capital gains provisions' means the provisions of paragraph (2) of section 402(a) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) and paragraph (2) of section 403(a) of such Code (as so in effect).

(7) Subsection (d).—The amendments made by subsection (d) shall apply to taxable years beginning after December 31, 1985.

(8) Frozen deposits.—The amendments made by subsection (e)(2) shall apply to amounts transferred to an employee before, on, or after the date of the enactment of this Act, except that in the case of an amount transferred on or before such date, the 60-day period referred to in section 402(a)(5)(C) of the Internal Revenue Code of 1986 shall not expire before the 60th day after the date of the enactment of this Act.

SEC. 1123. UNIFORM ADDITIONAL TAX ON EARLY DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.

(a) In General.—Section 72 (relating to annuities; certain proceeds of endowment and life insurance contracts) is amended by redesignating subsection (t) as subsection (u) and by inserting after subsection (s) the following new subsection:

"(t) 10-Percent Additional Tax on Early Distributions From Qualified Retirement Plans.—

"(1) Imposition of additional tax.—If any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

"(2) Subsection not to apply to certain distributions.—Except as provided in paragraphs (3) and (4), paragraph (1) shall not apply to any of the following distributions:

"(A) In general.—Distributions which are—

"(i) made on or after the date on which the employee attains age 59½,

"(ii) made to a beneficiary (or to the estate of the employee) on or after the death of the employee,

"(iii) attributable to the employee's being disabled within the meaning of subsection (m)(7),

"(iv) part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the employee or the joint

lives (or joint life expectancies) of such employee and his beneficiary, or

"(v) made to an employee after separation from service on account of early retirement under the plan after attainment of age 55, or

"(vi) dividends paid with respect to stock of a corporation which are described in section 404(k).

"(B) MEDICAL EXPENSES.—Distributions made to the employee (other than distributions described in subparagraph (A) or (C)) to the extent such distributions do not exceed the amount allowable as a deduction under section 213 to the employee for amounts paid during the taxable year for medical care (determined without regard to whether the employee itemizes deductions for such taxable year).

"(C) CERTAIN PLANS.—

"(i) IN GENERAL.—Except as provided in clause (ii), any distribution made before January 1, 1990, to an employee from an employee stock ownership plan defined in section 4975(e)(7) to the extent that, on average, a majority of assets in the plan have been invested in employer securities (as defined in section 409(l)) for the 5-plan-year period preceding the plan year in which the distribution is made.

"(ii) BENEFITS DISTRIBUTED MUST BE INVESTED IN EMPLOYER SECURITIES FOR 5 YEARS.—Clause (i) shall not apply to any distribution which is attributable to assets which have not been invested in employer securities at all times during the period referred to in clause (i).

"(D) PAYMENTS TO ALTERNATE PAYEES PURSUANT TO QUALIFIED DOMESTIC RELATIONS ORDERS.—Any distribution to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)(1)).

"(3) LIMITATIONS.—

"(A) CERTAIN EXCEPTIONS NOT TO APPLY TO INDIVIDUAL RETIREMENT PLANS.—Subparagraphs (A)(v), (B), and (C) of paragraph (2) shall not apply to distributions from an individual retirement plan.

"(B) PERIODIC PAYMENTS UNDER QUALIFIED PLANS MUST BEGIN AFTER SEPARATION.—Paragraph (2)(A)(iv) shall not apply to any amount paid from a trust described in section 401(a) which is exempt from tax under section 501(a) or from a contract described in section 72(e)(5)(D)(ii) unless the series of payments begins after the employee separates from service.

"(4) CHANGE IN SUBSTANTIALLY EQUAL PAYMENTS.—

"(A) IN GENERAL.—If—

"(i) paragraph (1) does not apply to a distribution by reason of paragraph (2)(A)(iv), and

"(ii) the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)—

"(I) before the close of the 5-year period beginning with the date of the first payment and after the employee attains age 59½, or

"(II) before the employee attains age 59½,

the taxpayer's tax for the 1st taxable year in which such modification occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for paragraph (2)(A)(iv)) would have been imposed, plus interest for the deferral period.

"(B) DEFERRAL PERIOD.—For purposes of this paragraph, the term 'deferral period' means the period beginning with the taxable year in which (without regard to paragraph (2)(A)(iv)) the distribution would have been includible in gross income and ending with the taxable year in which the modification described in subparagraph (A) occurs.

"(5) EMPLOYEE.—For purposes of this subsection, the term 'employee' includes any participant, and in the case of an individual retirement plan, the individual for whose benefit such plan was established."

(b) CONFORMING CHANGES TO TAX ON PREMATURE DISTRIBUTIONS FROM ANNUITY CONTRACTS; EXCEPTION FOR QUALIFIED FUNDING ASSETS.—

(1) INCREASE IN RATE.—Section 72(q) is amended—

(A) by striking out "5 percent" in paragraph (1) thereof and inserting in lieu thereof "10 percent", and

(B) by striking out "5-PERCENT" in the heading thereof and inserting in lieu thereof "10-PERCENT".

(2) PERIODIC PAYMENTS.—Subparagraph (D) of section 72(q)(2) is amended to read as follows:

"(D) which is a part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his beneficiary."

(3) ADDITIONAL TAX.—Section 72(q) is amended by adding at the end thereof the following new paragraph:

"(3) CHANGE IN SUBSTANTIALLY EQUAL PAYMENTS.—If—

"(A) paragraph (1) does not apply to a distribution by reason of paragraph (2)(D), and

"(B) the series of payments under such paragraph are subsequently modified (other than by reason of death or disability)—

"(i) before the close of the 5-year period beginning on the date of the first payment and after the employee attains age 59½, or

"(ii) before the employee attains age 59½,

the taxpayer's tax for the 1st taxable year in which such modification occurs shall be increased by an amount, determined under regulations, equal to the tax which (but for paragraph (2)(D)) would have been imposed, plus interest for the deferral period (within the meaning of subsection (t)(4)(B))."

(3) Paragraph (2) of section 72(q) is amended by striking out "This subsection" and inserting in lieu thereof "Paragraph (1)".

(4) Section 72(q)(2), as amended by this Act, is amended by striking out "or" at the end of subparagraph (G), by striking out the period at the end of subparagraph (H), and by adding at the end thereof the following new subparagraphs:

"(I) under an immediate annuity contract (within the meaning of section 72(u)(4)), or

"(J) which is purchased by an employer upon the termination of a plan described in section 401(a) or 403(a) and which is held by the employer until such time as the employee separates from service."

(c) Amendments to Section 403(b).—

(1) In general.—Subsection (b) of section 403 (relating to taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school) is amended by adding at the end thereof the following new paragraph:

"(11) Requirement that distributions not begin before age 59½, separation from service, death, or disability.—This subsection shall not apply to any annuity contract unless under such contract distributions attributable to contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only—

"(A) when the employee attains age 59½, separates from service, dies, or becomes disabled (within the meaning of section 72(m)(7)), or

"(B) in the case of hardship.

Such contract may not provide for the distribution of any income attributable to such contributions in the case of hardship."

(2) Custodial accounts.—Clause (ii) of section 403(b)(7) (relating to amounts treated as contributions) is amended by inserting "in the case of contributions made pursuant to a salary reduction agreement (within the meaning of section 3121(a)(1)(D))," before "encounters".

(d) Technical Amendments.—

(1) Subparagraph (A) of section 72(m)(5) is amended to read as follows:

"(A) This paragraph applies to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by an individual who is, or has been, a 5-percent owner, or by a successor of such an individual, but only to the extent such amounts are determined, under regulations prescribed by the Secretary, to exceed the benefits provided for such individual under the plan formula."

(2) Subsection (f) of section 408 is hereby repealed.

(e) Effective Date.—

(1) In general.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Subsection (c).—The amendments made by subsection (c) shall apply to taxable years beginning after December 31, 1988.

(3) Exception where distribution commences.—The amendments made by this section shall not apply to distribu-

tions to any employee from a plan maintained by any employer if—

(A) as of March 1, 1986, the employee separated from service with the employer,

(B) as of March 1, 1986, the accrued benefit of the employee was in pay status pursuant to a written election providing a specific schedule for the distribution of the entire accrued benefit of the employee, and

(C) such distribution is made pursuant to such written election.

(4) TRANSITION RULE.—The amendments made by this section shall not apply with respect to any benefits with respect to which a designation is in effect under section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act of 1982.

SEC. 1124. ELECTION TO TREAT CERTAIN LUMP SUM DISTRIBUTIONS RECEIVED DURING 1987 AS RECEIVED DURING 1986.

(a) IN GENERAL.—If an employee separates from service during 1986 and receives a lump sum distribution (within the meaning of section 402(e)(4)(A) of such Code) after December 31, 1986, and before March 16, 1987, on account of such separation from service, then, for purposes of the Internal Revenue Code of 1986, such employee may elect to treat such lump sum distribution as if it were received when such employee separated from service.

(b) SPECIAL RULE FOR TERMINATED PLAN.—In the case of an employee who receives a distribution from a terminated plan which was maintained by a corporation organized under the laws of the State of Nevada, the principal place of business of which is Denver, Colorado, and which filed for relief from creditors under the United States Bankruptcy Code on August 28, 1986, the employee may treat a lump sum distribution received from such plan before June 30, 1987, as if it were received in 1986.

PART IV—MISCELLANEOUS PROVISIONS

SEC. 1131. ADJUSTMENTS TO SECTION 404 LIMITATIONS.

(a) ELIMINATION OF LIMIT CARRYFORWARD OF SECTION 404(a)(3)(A).—Subparagraph (A) of section 404(a)(3) (relating to limits on deductible contributions to stock bonus and profit-sharing trusts) is amended to read as follows:

"(A) LIMITS ON DEDUCTIBLE CONTRIBUTIONS.—

"(i) IN GENERAL.—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan.

"(ii) CARRYOVER OF EXCESS CONTRIBUTIONS.—Any amount paid into the trust in any taxable year in excess of the limitation of clause (i) (or the corresponding provision of prior law) shall be deductible in the succeeding taxable years in order of time, but the

amount so deductible under this clause in any 1 such succeeding taxable year together with the amount allowable under clause (i) shall not exceed 15 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plan.

"(iii) CERTAIN RETIREMENT PLANS EXCLUDED.—For purposes of this subparagraph, the term 'stock bonus or profit-sharing trust' shall not include any trust designed to provide benefits upon retirement and covering a period of years, if under the plan the amounts to be contributed by the employer can be determined actuarially as provided in paragraph (1).

"(iv) 2 OR MORE TRUSTS TREATED AS 1 TRUST.—If the contributions are made to 2 or more stock bonus or profit-sharing trusts, such trusts shall be considered a single trust for purposes of applying the limitations in this subparagraph.

"(v) PRE-87 LIMITATION CARRYFORWARDS.—

"(I) IN GENERAL.—The limitation of clause (i) for any taxable year shall be increased by the unused pre-87 limitation carryforwards (but not to an amount in excess of 25 percent of the compensation described in clause (i)).

"(II) UNUSED PRE-87 LIMITATION CARRYFORWARDS.—For purposes of subclause (I), the term 'unused pre-87 limitation carryforwards' means the amount by which the limitation of the first sentence of this subparagraph (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) for any taxable year beginning before January 1, 1987, exceeded the amount paid to the trust for such taxable year (to the extent such excess was not taken into account in prior taxable years)."

(b) COMBINED LIMIT TO APPLY TO COMBINATIONS OF DEFINED CONTRIBUTION PLANS AND DEFINED BENEFIT PLANS.—Paragraph (7) of section 404(a) is amended to read as follows:

"(7) LIMITATION ON DEDUCTIONS WHERE COMBINATION OF DEFINED CONTRIBUTION PLAN AND DEFINED BENEFIT PLAN.—

"(A) IN GENERAL.—If amounts are deductible under the foregoing provisions of this subsection (other than paragraph (5)) in connection with 1 or more defined contribution plans and 1 or more defined benefit plans, the total amount deductible in a taxable year under such plans shall not exceed the greater of—

"(i) 25 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under such plans, or

"(ii) the amount of contributions made to or under the defined benefit plans to the extent such contributions do not exceed the amount of employer contributions necessary to satisfy the minimum funding standard provided by section 412 with respect to any such defined benefit plans for the plan year which ends

with or within such taxable year (or for any prior plan year).

A defined contribution plan which is a pension plan shall not be treated as failing to provide definitely determinable benefits merely by limiting employer contributions to amounts deductible under this section.

"(B) CARRYOVER OF CONTRIBUTIONS IN EXCESS OF THE DEDUCTIBLE LIMIT.—Any amount paid under the plans in any taxable year in excess of the limitation of subparagraph (A) shall be deductible in the succeeding taxable years in order of time, but the amount so deductible under this subparagraph in any 1 such succeeding taxable year together with the amount allowable under subparagraph (A) shall not exceed 25 percent of the compensation otherwise paid or accrued during such taxable year to the beneficiaries under the plans.

"(C) PARAGRAPH NOT TO APPLY IN CERTAIN CASES.—This paragraph shall not have the effect of reducing the amount otherwise deductible under paragraphs (1), (2), and (3), if no employee is a beneficiary under more than 1 trust or under a trust and an annuity plan.

"(D) SECTION 412(i) PLANS.—For purposes of this paragraph, any plan described in section 412(i) shall be treated as a defined benefit plan."

(c) EXCISE TAX ON NONDEDUCTIBLE CONTRIBUTIONS TO QUALIFIED EMPLOYER PLANS.—

(1) IN GENERAL.—Chapter 43 (relating to qualified pension, etc., plans) is amended by inserting after section 4971 the following new section:

"SEC. 4972. TAX ON NONDEDUCTIBLE CONTRIBUTIONS TO QUALIFIED EMPLOYER PLANS.

"(a) TAX IMPOSED.—In the case of any qualified employer plan, there is hereby imposed a tax equal to 10 percent of the nondeductible contributions under the plan (determined as of the close of the taxable year of the employer).

"(b) EMPLOYER LIABLE FOR TAX.—The tax imposed by this section shall be paid by the employer making the contributions.

"(c) NONDEDUCTIBLE CONTRIBUTIONS.—For purposes of this section, the term 'nondeductible contributions' means, with respect to any qualified employer plan, the sum of—

"(1) the excess (if any) of—

"(A) the amount contributed for the taxable year by the employer to or under such plan, over

"(B) the amount allowable as a deduction under section 404 for such contributions, and

"(2) the amount determined under this subsection for the preceding taxable year reduced by the sum of—

"(A) the portion of the amount so determined returned to the employer during the taxable year, and

"(B) the portion of the amount so determined deductible under section 404 for the taxable year.

"(d) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED EMPLOYER PLAN.—*The term 'qualified employer plan' means—*

"(A) any plan meeting the requirements of section 401(a) which includes a trust exempt from the tax under section 501(a),

"(B) an annuity plan described in section 403(a), and

"(C) any simplified employee pension (within the meaning of section 408(k)).

"(2) EMPLOYER.—*In the case of a plan which provides contributions or benefits for employees some or all of whom are self-employed individuals within the meaning of section 401(c)(1), the term 'employer' means the person treated as the employer under section 401(c)(4)."*

(2) CLERICAL AMENDMENT.—*The table of sections for chapter 43 is amended by inserting after the item relating to section 4971 the following item:*

"Sec. 4972. Tax on nondeductible contributions to qualified employer plans."

(d) EFFECTIVE DATE.—*The amendments made by this section shall apply to taxable years beginning after December 31, 1986.*

SEC. 1132. EXCISE TAX ON REVERSION OF QUALIFIED PLAN ASSETS TO EMPLOYER.

(a) GENERAL RULE.—*Chapter 43 (relating to qualified pension, etc., plans) is amended by adding at the end thereof the following new section:*

"SEC. 4980. TAX ON REVERSION OF QUALIFIED PLAN ASSETS TO EMPLOYER.

"(a) IMPOSITION OF TAX.—*There is hereby imposed a tax of 10 percent of the amount of any employer reversion from a qualified plan.*

"(b) LIABILITY FOR TAX.—*The tax imposed by subsection (a) shall be paid by the employer maintaining the plan.*

"(c) DEFINITIONS AND SPECIAL RULES.—*For purposes of this section—*

"(1) QUALIFIED PLAN.—*The term 'qualified plan' means any plan meeting the requirements of section 401(a) or 403(a), other than—*

"(A) a plan maintained by an employer if such employer has, at all times, been exempt from tax under this subtitle, or

"(B) a governmental plan (within the meaning of section 414(d)).

Such term shall include any plan which, at any time, has been determined by the Secretary to be a qualified plan.

"(2) EMPLOYER REVERSION.—

"(A) IN GENERAL.—*The term 'employer reversion' means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.*

"(B) EXCEPTIONS.—*The term 'employer reversion' shall not include—*

"(i) except as provided in regulations, any amount distributed to or on behalf of any employee (or his beneficiaries) if such amount could have been so dis-

tributed before termination of such plan without violating any provision of section 401, or

"(ii) any distribution to the employer which is allowable under section 401(a)(2)—

"(I) in the case of a multiemployer plan, by reason of mistakes of law or fact or the return of any withdrawal liability payment,

"(II) in the case of a plan other than a multiemployer plan, by reason of mistake of fact, or

"(III) in the case of any plan, by reason of the failure of the plan to initially qualify or the failure of contributions to be deductible.

"(3) Exception for employee stock ownership plans.—

"(A) In general.—If, upon an employer reversion from a qualified plan, any applicable amount is transferred from such plan to an employee stock ownership plan described in section 4975(e)(7), such amount shall not be treated as an employer reversion for purposes of this section (or includible in the gross income of the employer) if—

"(i) the requirements of subparagraphs (B), (C), and (D) are met, and

"(ii) under the plan, employer securities to which subparagraph (B) applies must remain in the plan until distribution to participants in accordance with the provisions of such plan.

"(B) Investment in employer securities.—The requirements of this subparagraph are met if, within 90 days after the transfer (or such longer period as the Secretary may prescribe), the amount transferred is invested in employer securities (as defined in section 409(l)) or used to repay loans used to purchase such securities.

"(C) Allocation requirements.—The requirements of this subparagraph are met if the portion of the amount transferred which is not allocated (by reason of the limitations of section 415) under the plan to accounts of participants in the plan year in which the transfer occurs—

"(i) is credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably over a period not to exceed 7 years, and

"(ii) when allocated to accounts of participants under the plan, is treated as an employer contribution for purposes of section 415(c), except that—

"(I) the annual addition (as determined under section 415(c)) attributable to each such allocation shall not exceed the value of such securities as of the time such securities were credited to such suspense account, and

"(II) no additional employer contributions shall be permitted to an employee stock ownership plan described in subparagraph (A) of the employer before the allocation of such amount.

"(D) Participants.—The requirements of this subparagraph are met if at least half of the participants in the

qualified plan are participants in the employee stock ownership plan (as of the close of the 1st plan year for which an allocation of the securities is required).

"(E) APPLICABLE AMOUNT.—For purposes of this paragraph, the term 'applicable amount' means any amount which—

"(i) is transferred after March 31, 1985, and before January 1, 1989, or

"(ii) is transferred after December 31, 1988, pursuant to a termination which occurs after March 31, 1985, and before January 1, 1989."

(b) CLERICAL AMENDMENT.—The table of sections for chapter 43 is amended by adding at the end thereof the following new item:

"Sec. 4980. Tax on reversion of qualified plan assets to employer."

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—The amendments made by this section shall apply to reversions occurring after December 31, 1985.

(2) EXCEPTION WHERE TERMINATION DATE OCCURRED BEFORE JANUARY 1, 1986.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by this section shall not apply to any reversion after December 31, 1985, which occurs pursuant to a plan termination where the termination date is before January 1, 1986.

(B) ELECTION TO HAVE AMENDMENTS APPLY.—A corporation may elect to have the amendments made by this section apply to any reversion after 1985 pursuant to a plan termination occurring before 1986 if such corporation was incorporated in the State of Delaware in March, 1978, and became a parent corporation of the consolidated group on September 19, 1978, pursuant to a merger agreement recorded in the State of Nevada on November 19, 1978.

(3) TERMINATION DATE.—For purposes of paragraph (2), the term "termination date" is the date of the termination (within the meaning of section 411(d)(3) of the Internal Revenue Code of 1986) of the plan.

(4) TRANSITION RULE FOR CERTAIN TERMINATIONS.—

(A) IN GENERAL.—In the case of a taxpayer to which this paragraph applies, the amendments made by this section shall not apply to any termination occurring before the date which is 1 year after the date of the enactment of this Act.

(B) TAXPAYERS TO WHOM PARAGRAPH APPLIES.—This paragraph shall apply to—

(i) a corporation incorporated on June 13, 1917, which has its principal place of business in Bartlesville, Oklahoma,

(ii) a corporation incorporated on January 17, 1917, which is located in Coatesville, Pennsylvania,

(iii) a corporation incorporated on January 23, 1928, which has its principal place of business in New York, New York,

(iv) a corporation incorporated on April 23, 1956, which has its principal place of business in Dallas, Texas, and

(v) a corporation incorporated in the State of Nevada, the principal place of business of which is in Denver, Colorado, and which filed for relief from creditors under the United States Bankruptcy Code on August 28, 1986.

SEC. 1133. TAX ON EXCESS DISTRIBUTIONS.

(a) GENERAL RULE.—Chapter 43 (relating to tax on pension, etc., plans) is amended by adding at the end thereof the following new section:

"SEC. 4981. TAX ON EXCESS DISTRIBUTIONS FROM QUALIFIED RETIREMENT PLANS.

"(a) GENERAL RULE.—There is hereby imposed a tax equal to 15 percent of the excess distributions with respect to any individual during any calendar year.

"(b) LIABILITY FOR TAX.—The individual with respect to whom the excess distributions are made shall be liable for the tax imposed by subsection (a). The amount of the tax imposed by subsection (a) shall be reduced by the amount (if any) of the tax imposed by section 72(t) to the extent attributable to such excess distributions.

"(c) EXCESS DISTRIBUTIONS.—For purposes of this section—

"(1) IN GENERAL.—The term 'excess distributions' means the aggregate amount of the retirement distributions with respect to any individual during any calendar year to the extent such amount exceeds $112,500 (adjusted at the same time and in the same manner as under section 415(d)).

"(2) EXCLUSION OF CERTAIN DISTRIBUTIONS.—The following distributions shall not be taken into account under paragraph (1):

"(A) Any retirement distribution with respect to an individual made after the death of such individual.

"(B) Any retirement distribution with respect to an individual payable to an alternate payee pursuant to a qualified domestic relations order (within the meaning of section 414(p)) if includible in income of the alternate payee.

"(C) Any retirement distribution with respect to an individual which is attributable to the employee's investment in the contract (as defined in section 72(f)).

"(D) Any retirement distribution to the extent not included in gross income by reason of a rollover contribution.

Any distribution described in subparagraph (B) shall be treated as a retirement distribution to the person to whom paid for purposes of this section.

"(3) AGGREGATION OF PAYMENTS.—If retirement distributions with respect to any individual during any calendar year are received by the individual and 1 or more other persons, all such distributions shall be aggregated for purposes of determining the amount of the excess distributions for the calendar year.

"(4) SPECIAL RULE WHERE TAXPAYER ELECTS INCOME AVERAGING.—If the retirement distributions with respect to any indi-

vidual during any calendar year include a lump sum distribution to which an election under section 402(e)(4)(B) applies—

"(A) paragraph (1) shall be applied separately with respect to such lump sum distribution and other retirement distributions, and

"(B) the limitation under paragraph (1) with respect to such lump sum distribution shall be equal to 5 times the amount of such limitation determined without regard to this subparagraph.

"(5) SPECIAL RULE FOR ACCRUED BENEFITS AS OF AUGUST 1, 1986.—

"(A) IN GENERAL.—If the employee elects on a return filed for a taxable year ending before January 1, 1989 to have this paragraph apply, the portion of any retirement distribution which is attributable (as determined under rules prescribed by the Secretary) to the accrued benefit of an employee as of August 1, 1986, shall be taken into account for purposes of paragraph (1), but no tax shall be imposed under this section with respect to such portion of such distribution.

"(B) LIMITATION.—An employee may not make an election under subparagraph (A) unless the accrued benefit of such employee as of August 1, 1986, exceeds $562,500.

"(C) TAXPAYER NOT MAKING ELECTION.—If an employee does not elect the application of this paragraph, paragraph (1) shall be applied by substituting $150,000 for such dollar limitation unless such dollar limitation is greater than $150,000.

"(d) INCREASE IN ESTATE TAX IF INDIVIDUAL DIES WITH EXCESS ACCUMULATION.—

"(1) IN GENERAL.—The tax imposed by chapter 11 with respect to the estate of any individual shall be increased by an amount equal to 15 percent of the individual's excess retirement accumulation.

"(2) NO CREDIT ALLOWABLE.—No credit shall be allowable under section 2010 with respect to any portion of the tax imposed by chapter 11 attributable to the increase under paragraph (1).

"(3) EXCESS RETIREMENT ACCUMULATION.—For purposes of paragraph (1), the term 'excess retirement accumulation' means the excess (if any) of—

"(A) the value of the individual's interests in qualified employer plans and individual retirement plans as of the date of the decedent's death (or, in the case of an election under section 2032, the applicable valuation date prescribed by such section), over

"(B) the present value (as determined under rules prescribed by the Secretary as of the valuation date prescribed in subparagraph (A)) of an annuity for a term certain—

"(i) with annual payments equal to the limitation of subsection (c) (as in effect for the year in which the death occurs), and

"(ii) payable for a period equal to the life expectancy of the individual immediately before his death.

"(e) Retirement Distributions.—For purposes of this section—

"(1) In general.—The term 'retirement distribution' means, with respect to any individual, the amount distributed during the taxable year under—

"(A) any qualified employer plan with respect to which such individual is or was the employee, and

"(B) any individual retirement plan.

"(2) Qualified employer plan.—The term 'qualified employer plan' means—

"(A) any plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

"(B) an annuity plan described in section 403(a), or

"(C) an annuity contract described in section 403(b).

Such term includes any plan or contract which, at any time, has been determined by the Secretary to be such a plan or contract."

(b) Clerical Amendment.—The table of sections for chapter 43 is amended by adding at the end thereof the following new item:

"Sec. 4981. Tax on excess distributions from qualified retirement plans."

(c) Effective Dates.—

(1) In general.—Except as provided in this subsection, the amendments made by this section shall apply to distributions made after December 31, 1986.

(2) Estate tax.—Section 4981(d) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to the estates of decedents dying after December 31, 1986.

(3) Plan terminations before 1987.—The amendments made by this section shall not apply to distributions before January 1, 1988, which are made on account of the termination of a qualified employer plan if such termination occurred before January 1, 1987.

SEC. 1134. TREATMENT OF LOANS.

(a) $50,000 Limitation Reduced by Balance of Certain Preceding Loans.—Clause (i) of section 72(p)(2)(A) (relating to exceptions for certain loans) is amended to read as follows:

"(i) $50,000, reduced by the excess (if any) of—

"(I) the highest outstanding balance of loans from the plan during the 1-year period ending on the day before the date on which such loan was made, over

"(II) the outstanding balance of loans from the plan on the date on which such loan was made, or".

(b) Level Amortization of Loan Required.—Paragraph (2) of section 72(p) is amended by redesignating subparagraph (C) as subparagraph (D) and inserting after subparagraph (B) the following new subparagraph:

"(C) Requirement of level amortization.—Except as provided in regulations, this paragraph shall not apply to any loan unless substantially level amortization of such loan (with payments not less frequently than quarterly) is required over the term of the loan."

(c) DENIAL OF INTEREST DEDUCTION IN CERTAIN CASES.—Subsection (p) of section 72 is amended by redesignating paragraphs (3) and (4) as paragraphs (4) and (5), respectively and by inserting after paragraph (2) the following new paragraph:

"(3) DENIAL OF INTEREST DEDUCTIONS IN CERTAIN CASES.—

"(A) IN GENERAL.—No deduction otherwise allowable under this chapter shall be allowed under this chapter for any interest paid or accrued on any loan described in subparagraph (B).

"(B) LOANS TO WHICH SUBPARAGRAPH (A) APPLIES.—For purposes of subparagraph (A), a loan is described in this subparagraph—

"(i) if paragraph (1) does not apply to such loan by reason of paragraph (2), and

"(ii) if—

"(I) such loan is made to a key employee (as defined in section 416(i)), or

"(II) such loan is secured by amounts attributable to elective 401(k) or 403(b) deferrals (as defined in section 402(g)(3))."

(d) EXCEPTION FOR HOME LOANS LIMITED TO ACQUISITION OF PRINCIPAL RESIDENCE.—Clause (ii) of section 72(p)(2)(B) is amended to read as follows:

"(ii) EXCEPTION FOR HOME LOANS.—Clause (i) shall not apply to any loan used to acquire any dwelling unit which within a reasonable time is to be used (determined at the time the loan is made) as the principal residence of the participant."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to loans made, renewed, renegotiated, modified, or extended after December 31, 1986.

SEC. 1135. DEFERRED ANNUITIES AVAILABLE ONLY TO NATURAL PERSONS.

(a) GENERAL RULE.—Section 72, as amended by section 1223, is amended by redesignating subsection (u) as subsection (v) and by inserting after subsection (t) the following new subsection:

"(u) TREATMENT OF ANNUITY CONTRACTS NOT HELD BY NATURAL PERSONS.—

"(1) IN GENERAL.—If any annuity contract is held by a person who is not a natural person—

"(A) such contract shall not be treated as an annuity contract for purposes of this subtitle, and

"(B) the income on the contract for any taxable year of the policyholder shall be treated as ordinary income received or accrued by the owner during such taxable year.

For purposes of this paragraph, holding by a trust or other entity as an agent for a natural person shall not be taken into account.

"(2) INCOME ON THE CONTRACT.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'income on the contract' means, with respect to any taxable year of the policyholder, the excess of—

"(i) the sum of the net surrender value of the contract as of the close of the taxable year plus all distri-

butions under the contract received during the taxable year or any prior taxable year, reduced by

"(ii) the sum of the amount of net premiums under the contract for the taxable year and prior taxable years and amounts includible in gross income for prior taxable years with respect to such contract under this subsection.

Where necessary to prevent the avoidance of this subsection, the Secretary may substitute 'fair market value of the contract' for 'net surrender value of the contract' each place it appears in the preceding sentence.

"(B) NET PREMIUMS.—For purposes of this paragraph, the term 'net premiums' means the amount of premiums paid under the contract reduced by any policyholder dividends.

"(3) EXCEPTIONS.—This subsection shall not apply to any annuity contract which—

"(A) is acquired by the estate of a decedent by reason of the death of the decedent,

"(B) is held under a plan described in section 401(a) or 403(a), under a program described in section 403(b), or under an individual retirement plan,

"(C) is a qualified funding asset (as defined in section 130(d), but without regard to whether there is a qualified assignment),

"(D) which is purchased by an employer upon the termination of a plan described in section 401(a) or 403(a) and which is held by the employer until such time as the employee separates from service, or

"(E) which is an immediate annuity.

"(4) IMMEDIATE ANNUITY.—For purposes of this subsection, the term 'immediate annuity' means an annuity—

"(A) which is purchased with a single premium or annuity consideration, and

"(B) the annuity starting date (as defined in subsection (c)(4)) of which commences no later than 1 year from the date of the purchase of the annuity."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to contributions to annuity contracts after February 28, 1986.

SEC. 1136. PROFITS NOT REQUIRED FOR PROFIT-SHARING PLANS.

(a) IN GENERAL.—Subsection (a) of section 401, as amended by section 1112(b), is amended by inserting after paragraph (26) the following new paragraph:

"(27) The determination of whether the plan under which any contributions are made is a profit-sharing plan shall be made without regard to current or accumulated profits of the employer and without regard to whether the employer is a tax-exempt organization."

(b) CONFORMING AMENDMENTS.—Section 404(a)(2) and 818(a)(3), as amended by this Act, are each amended by striking out "and (26)" and inserting in lieu thereof "(26), and (27)".

(c) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1985.

SEC. 1137. REQUIREMENT THAT COLLECTIVE BARGAINING AGREEMENTS BE BONA FIDE.

Paragraph (46) of section 7701(a) (relating to determination of whether there is a collective bargaining agreement) is amended by adding at the end thereof the following new sentence: "An agreement shall not be treated as a collective bargaining agreement unless it is a bona fide agreement between bona fide employee representatives and 1 or more employers."

SEC. 1138. PENALTY ON UNDERPAYMENTS ATTRIBUTABLE TO OVERSTATEMENT OF PENSION LIABILITIES.

(a) General Rule.—Subchapter A of chapter 68 (relating to additions to tax) is amended by inserting after section 6659 the following new section:

"SEC. 6659A. ADDITION TO TAX IN CASE OF OVERSTATEMENTS OF PENSION LIABILITIES.

"(a) Addition to Tax.—In the case of an underpayment of the tax imposed by chapter 1 on any taxpayer for the taxable year which is attributable to an overstatement of pension liabilities, there shall be added to such tax an amount equal to the applicable percentage of the underpayment so attributable.

"(b) Applicable Percentage Defined.—For purposes of subsection (a), the applicable percentage shall be determined under the following table:

"If the valuation claimed is the following percent of the correct valuation—	***The applicable percentage is:***
150 percent or more but not more than 200 percent	*10*
More than 200 percent but not more than 250 percent	*20*
More than 250 percent	*30.*

"(c) Overstatement of Pension Liabilities.—For purposes of this section, there is an overstatement of pension liabilities if the actuarial determination of the liabilities taken into account for purposes of computing the deduction under paragraph (1) or (2) of section 404(a) exceeds the amount determined to be the correct amount of such liability.

"(d) Underpayment Must Be at Least $1,000.—This section shall not apply if the underpayment for the taxable year attributable to valuation overstatements is less than $1,000.

"(e) Authority To Waive.—The Secretary may waive all or any part of the addition to the tax provided by this section on a showing by the taxpayer that there was a reasonable basis for the valuation claimed on the return and that such claim was made in good faith."

(b) Clerical Amendment.—The table of sections for subchapter A of chapter 68 is amended by inserting after the item relating to section 6659 the following new item:

"Sec. 6659A. Addition to tax in case of overstatements of pension liabilities."

(c) Effective Date.—The amendment made by this section shall apply to overstatements made after the date of the enactment of this Act.

SEC. 1139. INTEREST RATE ASSUMPTIONS.

(a) IN GENERAL.—Subparagraph (B) of section 411(a)(11) is amended to read as follows:

"(B) DETERMINATION OF PRESENT VALUE.—

"(i) IN GENERAL.—For purposes of subparagraph (A), the present value shall be calculated—

"(I) by using an interest rate no greater than the applicable interest rate if the vested accrued benefit (using such rate) is not in excess of $25,000, and

"(II) by using an interest rate no greater than 120 percent of the applicable interest rate if the vested accrued benefit exceeds $25,000 (as determined under subclause (I)).

In no event shall the present value determined under subclause (II) be less than $25,000.

"(ii) APPLICABLE INTEREST RATE.—For purposes of clause (i), the term 'applicable interest rate' means the interest rate which would be used (as of the date of the distribution) by the Pension Benefit Guaranty Corporation for purposes of determining the present value of a lump sum distribution on plan termination."

(b) CONFORMING AMENDMENT.—Paragraph (3) of section 417(e) (relating to determination of present value) is amended to read as follows:

"(3) DETERMINATION OF PRESENT VALUE.—

"(A) IN GENERAL.—For purposes of paragraphs (1) and (2), the present value shall be calculated—

"(i) by using an interest rate no greater than the applicable interest rate if the vested accrued benefit (using such rate) is not in excess of $25,000, and

"(ii) by using an interest rate no greater than 120 percent of the applicable interest rate if the vested accrued benefit exceeds $25,000 (as determined under clause (i)).

In no event shall the present value determined under subclause (II) be less than $25,000.

"(B) APPLICABLE INTEREST RATE.—For purposes of subparagraph (A), the term 'applicable interest rate' means the interest rate which would be used (as of the date of the distribution) by the Pension Benefit Guaranty Corporation for purposes of determining the present value of a lump sum distribution on plan termination."

(c) AMENDMENTS TO ERISA.—

(1) IN GENERAL.—Paragraph (2) of section 203(e) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(e)(2)) is amended to read as follows:

"(2)(A) For purposes of paragraph (1), the present value shall be calculated—

"(i) by using an interest rate no greater than the applicable interest rate if the vested accrued benefit (using such rate) is not in excess of $25,000, and

"(ii) by using an interest rate no greater than 120 percent of the applicable interest rate if the vested accrued benefit exceeds $25,000 (as determined under clause (i)).

In no event shall the present value determined under subclause (II) be less than $25,000.

"(B) APPLICABLE INTEREST RATE.*—For purposes of subparagraph (A), the term 'applicable interest rate' means the interest rate which would be used (as of the date of the distribution) by the Pension Benefit Guaranty Corporation for purposes of determining the present value of a lump sum distribution on plan termination."*

(2) CONFORMING AMENDMENT.*—Paragraph (3) of section 205(g) of such Act (29 U.S.C. 1055(g)(3)) is amended to read as follows:*

"(3)(A) For purposes of paragraphs (1) and (2), the present value shall be calculated—

"(i) by using an interest rate no greater than the applicable interest rate if the vested accrued benefit (using such rate) is not in excess of $25,000, and

"(ii) by using an interest rate no greater than 120 percent of the applicable interest rate if the vested accrued benefit exceeds $25,000 (as determined under clause (i)).

In no event shall the present value determined under subclause (II) be less than $25,000.

"(B) For purposes of subparagraph (A), the term 'applicable interest rate' means the interest rate which would be used (as of the date of the distribution) by the Pension Benefit Guaranty Corporation for purposes of determining the present value of a lump sum distribution on plan termination.".

(d) EFFECTIVE DATE.*—*

(1) IN GENERAL.*—The amendments made by this section shall apply to distributions in plan years beginning after December 31, 1984, except that such amendments shall not apply to any distributions in plan years beginning after December 31, 1984, and before January 1, 1987, if such distributions were made in accordance with the requirements of the regulations issued under the Retirement Equity Act of 1984.*

(2) REDUCTION IN ACCRUED BENEFITS.*—*

(A) IN GENERAL.*—If a plan—*

(i) adopts a plan amendment before the close of the first plan year beginning on or before January 1, 1989, which provides for the calculation of the present value of the accrued benefits in the manner provided by the amendments made by this section, and

(ii) the plan reduces the accrued benefits for any plan year to which such plan amendment applies in accordance with such plan amendment,

such reduction shall not be treated as a violation of section 411(d)(6) of the Internal Revenue Code of 1986 or section 204(g) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054(g)).

(B) SPECIAL RULE.*--In the case of a plan maintained by a corporation incorporated on April 11, 1934, which is headquartered in Tarrant County, Texas—*

(i) such plan may be amended to remove the option of an employee to receive a lump sum distribution (within the meaning of section 402(e)(5) of such Code) if such amendment—

(I) is adopted within 1 year of the date of the enactment of this Act, and

(II) is not effective until 2 years after the employees are notified of such amendment, and

(ii) the present value of any vested accrued benefit of such plan determined during the 3-year period beginning on the date of the enactment of this Act shall be determined under the applicable interest rate (within the meaning of section 411(a)(11)(B)(ii) of such Code, except that if such value (as so determined) exceeds $50,000, then the value of any excess over $50,000 shall be determined by using the interest rate specified in the plan as of August 16, 1986.

SEC. 1140. PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989.

(a) In General.—If any amendment made by this subtitle or subtitle C requires an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after January 1, 1989, if—

(1) during the period after such amendment takes effect and before such first plan year, the plan is operated in accordance with the requirements of such amendment or in accordance with an amendment prescribed by the Secretary and adopted by the plan, and

(2) such plan amendment applies retroactively to the period after such amendment takes effect and such first plan year.

A pension plan shall not be treated as failing to provide definitely determinable benefits or contributions, or to be operated in accordance with the provisions of the plan, merely because it operates in accordance with this provision.

(b) Model Amendment.—

(1) Secretary to prescribe amendment.—The Secretary of the Treasury or his delegate shall prescribe an amendment or amendments which allow a plan to meet the requirements of any amendment made by this subtitle or subtitle C—

(A) which requires an amendment to such plan, and

(B) is effective before the first plan year beginning after December 31, 1988.

(2) Adoption by plan.—If a plan adopts the amendment or amendments prescribed under paragraph (1) and operates in accordance with such amendment or amendments, such plan shall not be treated as failing to provide definitely determinable benefits or contributions or to be operated in accordance with the provisions of the plan.

(c) Special Rule for Collectively Bargained Plans.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, subsection (a) shall be applied by substituting for the first plan year beginning on or after January 1, 1989, the first plan year beginning after the earlier of—

(1) the later of—

(A) January 1, 1989, or

(B) the date on which the last of such collective bargaining agreements terminate (determined without regard to any extension thereof after February 28, 1986), or

(2) January 1, 1991.

SEC. 1141. ISSUANCE OF FINAL REGULATIONS.

The Secretary of the Treasury or his delegate shall issue before February 1, 1988, such final regulations as may be necessary to carry out the amendments made by—

(1) section 1111, relating to application of nondiscrimination rules to integrated plans,

(2) section 1112, relating to coverage requirements for qualified plans,

(3) section 1113, relating to minimum vesting standards,

(4) section 1114, relating to the definition of highly compensated employee,

(5) section 1115, relating to separate lines of business and the definition of compensation,

(6) section 1116, relating to rules for section 401(k) plans,

(7) section 1117, relating to nondiscrimination requirements for employer matching and employer contribution,

(8) section 1120, relating to nondiscrimination requirements for tax sheltered annuities, and

(9) section 1133, relating to tax on excess distributions.

SEC. 1142. SECRETARY TO ACCEPT APPLICATIONS WITH RESPECT TO SECTION 401(k) PLANS.

The Secretary of the Treasury or his delegate shall, not later than May 1, 1987, begin accepting applications for opinion letters with respect to master and prototype plans for qualified cash or deferred arrangements under section 401(k) of the Internal Revenue Code of 1986.

SEC. 1143. TREATMENT OF CERTAIN FISHERMEN AS SELF-EMPLOYED INDIVIDUALS.

(a) IN GENERAL.—Section 401(c) is amended by adding at the end thereof the following new paragraph:

"(6) SPECIAL RULE FOR CERTAIN FISHERMEN.—For purposes of this subsection, the term 'self-employed individual' includes an individual described in section 3121(b)(20) (relating to certain fishermen)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

SEC. 1144. ACQUISITION OF GOLD AND SILVER COINS BY INDIVIDUAL RETIREMENT ACCOUNTS.

(a) IN GENERAL.—Section 408(m) (relating to investment in collectibles treated as distributions) is amended by adding at the end thereof the following new paragraph:

"(3) EXCEPTION FOR CERTAIN COINS.—In the case of an individual retirement account, paragraph (2) shall not apply to any gold coin described in paragraph (7), (8), (9), or (10) of section 5112(a) of title 31 or any silver coin described in section 5112(e) of title 31)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to acquisitions after December 31, 1986.

SEC. 1145. REQUIREMENT OF JOINT AND SURVIVOR ANNUITIES AND PRERETIREMENT SURVIVOR ANNUITIES NOT TO APPLY TO CERTAIN PLAN.

(a) In General.—Section 401(a)(11) (relating to requirement of joint and survivor annuity and preretirement survivor annuity) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

> *"(E) Exception for plans described in section 404(c).—This paragraph shall not apply to a plan which the Secretary has determined is a plan described in section 404(c) (or a continuation thereof) in which participation is substantially limited to individuals who, before January 1, 1976, ceased employment covered by the plan."*

(b) Amendments to the Employee Retirement Income Security Act of 1974.—Section 205(b) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(b)) is amended by adding at the end thereof the following new paragraph:

> *"(3) This section shall not apply to a plan which the Secretary of the Treasury or his delegate has determined is a plan described in section 404(c) of the Internal Revenue Code of 1986 (or a continuation thereof) in which participation is substantially limited to individuals who, before January 1, 1976, ceased employment covered by the plan."*

(c) Amendments to Retirement Equity Act.—Section 303 of the Retirement Equity Act of 1984 is amended by adding at the end thereof the following new subsection:

"(f) The amendments made by section 301 of this Act shall not apply to the termination of a defined benefit plan if such termination—

> *"(1) is pursuant to a resolution directing the termination of such plan which was adopted by the Board of Directors of a corporation on July 24, 1984, and*
>
> *"(2) occurred on November 30, 1984."*

(d) Effective Date.—The amendments made by this section shall apply as if included in the amendments made by the Retirement Equity Act of 1984.

SEC. 1146. TREATMENT OF LEASED EMPLOYEES.

(a) Modifications of Leased Employee Provisions.—

> *(1) General rule.—Paragraph (5) of section 414(n) (relating to safe harbor exemption) is amended to read as follows:*
>
> *"(5) Safe harbor.—*
>
> > *"(A) In general.—In the case of requirements described in subparagraphs (A) and (B) of paragraph (3), this subsection shall not apply to any leased employee with respect to services performed for a recipient if—*
> >
> > > *"(i) such employee is covered by a plan which is maintained by the leasing organization and meets the requirements of subparagraph (B), and*
> > >
> > > *"(ii) leased employees (determined without regard to this paragraph) do not constitute more than 20 percent of the recipient's nonhighly compensated work force.*
> >
> > *"(B) Plan requirements.—A plan meets the requirements of this subparagraph if—*

"(i) such plan is a money purchase pension plan with a nonintegrated employer contribution rate for each participant of at least 10 percent of compensation,

"(ii) such plan provides for full and immediate vesting, and

"(iii) each employee of the leasing organization (other than employees who perform substantially all of their services for the leasing organization) immediately participates in such plan.

Clause (iii) shall not apply to any individual whose compensation from the leasing organization in each plan year during the 4-year period ending with the plan year is less than $1,000.

"(C) DEFINITIONS.—For purposes of this paragraph—

"(i) HIGHLY COMPENSATED EMPLOYEE.—The term 'highly compensated employee' has the meaning given such term by section 414(q).

"(ii) NONHIGHLY COMPENSATED WORK FORCE.—The term 'nonhighly compensated work force' means the aggregate number of individuals (other than highly compensated employees)—

"(I) who are employees of the recipient (without regard to this subsection) and have performed services for the recipient (or for the recipient and related persons) on a substantially full-time basis for a period of at least 1 year, or

"(II) who are leased employees with respect to the recipient (determined without regard to this paragraph).

"(iii) COMPENSATION.—The term 'compensation' has the same meaning as when used in section 415; except that such term shall include—

"(I) any employer contribution under a qualified cash or deferred arrangement to the extent not included in gross income under section 402(a)(8) or 402(h)(1)(B),

"(II) any amount which the employee would have received in cash but for an election under a cafeteria plan (within the meaning of section 125), and

"(III) any amount contributed to an annuity contract described in section 403(b) pursuant to a salary reduction agreement (within the meaning of section 3121(a)(5)(D))."

(2) CLARIFICATION OF YEARS OF SERVICE.—Paragraph (4) of section 414(n) is amended to read as follows:

"(4) TIME WHEN FIRST CONSIDERED AS EMPLOYEE.—

"(A) IN GENERAL.—In the case of any leased employee, paragraph (1) shall apply only for purposes of determining whether the requirements listed in paragraph (3) are met for periods after the close of the period referred to in paragraph (2)(B).

"(B) YEARS OF SERVICE.—In the case of a person who is an employee of the recipient (whether by reason of this sub-

section or otherwise), for purposes of the requirements listed in paragraph (3), years of service for the recipient shall be determined by taking into account any period for which such employee would have been a leased employee but for the requirements of paragraph (2)(B).”

(3) CONFORMING AMENDMENT.—Paragraph (6) of section 414(n) is amended to read as follows:

“(6) OTHER RULES.—For purposes of this subsection—

“(A) RELATED PERSONS.—The term ‘related persons’ has the same meaning as when used in section 103(b)(6)(C).

“(B) EMPLOYEES OF ENTITIES UNDER COMMON CONTROL.—The rules of subsections (b), (c), (m), and (o) shall apply.”

(b) MINIMIZING RECORDKEEPING REQUIREMENTS.—

(1) IN GENERAL.—Subsection (o) of section 414 (relating to regulations) is amended by adding at the end thereof the following new sentence:

“The regulations prescribed under subsection (n) shall include provisions to minimize the recordkeeping requirements of subsection (n) in the case of an employer which has no top-heavy plans (within the meaning of section 416(g)) and which uses the services of persons (other than employees) for an insignificant percentage of the employer's total workload.”

(2) CONFORMING AMENDMENT.—Section 414(n)(1) is amended by striking out “except to the extent otherwise provided in regulations,”.

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1983.

(2) SUBSECTION (a)(1).—The amendment made by subsection (a)(1) shall apply to services performed after December 31, 1986.

(3) RECORDKEEPING REQUIREMENTS.—In the case of years beginning before the date of the enactment of this Act, the last sentence of section 414(o) shall be applied without regard to the requirement that an insignificant percentage of the workload be performed by persons other than employees.

SEC. 1147. TAX TREATMENT OF FEDERAL THRIFT SAVINGS FUND.

(a) IN GENERAL.—Section 7701 is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

“(j) TAX TREATMENT OF FEDERAL THRIFT SAVINGS FUND.—

“(1) IN GENERAL.—For purposes of this title—

“(A) the Thrift Savings Fund shall be treated as a trust described in section 401(a) which is exempt from taxation under section 501(a);

“(B) any contribution to, or distribution from, the Thrift Savings Fund shall be treated in the same manner as contributions to or distributions from such a trust; and

“(C) subject to the provisions of paragraph (2) and any dollar limitation on the application of section 402(a)(8), contributions to the Thrift Savings Fund shall not be treated as distributed or made available to an employee or Member nor as a contribution made to the Fund by an em-

ployee or Member merely because the employee or Member has, under the provisions of subchapter III of chapter 84 of title 5, United States Code, and section 8351 of such title 5, an election whether the contribution will be made to the Thrift Savings Fund or received by the employee or Member in cash.

"(2) NONDISCRIMINATION REQUIREMENTS.—Paragraph (1)(C) shall not apply to the Thrift Savings Fund unless the Fund meets the antidiscrimination requirements (other than any requirement relating to coverage) applicable to arrangements described in section 401(k) and to matching contributions. Rules similar to the rules of sections 401(k)(8) and 401(m)(8) (relating to no disqualification if excess contributions distributed) shall apply for purposes of the preceding sentence.

"(3) COORDINATION WITH SOCIAL SECURITY ACT.—Paragraph (1) shall not be construed to provide that any amount of the employee's or Member's basic pay which is contributed to the Thrift Savings Fund shall not be included in the term 'wages' for the purposes of section 209 of the Social Security Act or section 3121(a) of this title.

"(4) DEFINITIONS.—For purposes of this subsection, the terms 'Member', 'employee', and 'Thrift Savings Fund' shall have the same respective meanings as when used in subchapter III of chapter 84 of title 5, United States Code.

"(5) COORDINATION WITH OTHER PROVISIONS OF LAW.—No provision of law not contained in this title shall apply for purposes of determining the treatment under this title of the Thrift Savings Fund or any contribution to, or distribution from, such Fund."

(b) CONFORMING AMENDMENT.—Section 3121(v)(3) (defining exempt governmental deferred compensation plan) is amended by striking out "and" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B), and inserting in lieu thereof ", and", and by inserting after subparagraph (B) the following new subparagraph:

"(C) the Thrift Saving Fund (within the meaning of subchapter III of chapter 84 of title 5, United States Code)."

Subtitle B—Employee Benefit Provisions

PART I—NONDISCRIMINATION RULES FOR CERTAIN STATUTORY EMPLOYEE BENEFIT PLANS

SEC. 1151. NONDISCRIMINATION RULES FOR COVERAGE AND BENEFITS UNDER CERTAIN STATUTORY EMPLOYEE BENEFIT PLANS.

(a) GENERAL RULE.—Part II of subchapter B of chapter 1 (relating to items specifically included in gross income) is amended by adding at the end thereof the following new section:

"SEC. 89. BENEFITS PROVIDED UNDER CERTAIN EMPLOYEE BENEFIT PLANS.

"(a) BENEFITS UNDER DISCRIMINATORY PLANS.—

"(1) IN GENERAL.—Notwithstanding any provision of part III of this subchapter, gross income of a highly compensated em-

ployee who is a participant in a discriminatory employee benefit plan during any plan year shall include an amount equal to such employee's excess benefit under such plan for such plan year.

"(2) Year of inclusion.—Any amount included in gross income under paragraph (1) shall be taken into account for the taxable year of the employee with or within which the plan year ends.

"(b) Excess Benefit.—For purposes of this section—

"(1) In general.—The excess benefit of any highly compensated employee is the excess of such employee's employer-provided benefit under the plan over the highest permitted benefit.

"(2) Highest permitted benefit.—For purposes of paragraph (1), the highest permitted benefit under any plan shall be determined by reducing the nontaxable benefits of highly compensated employees (beginning with the employees with the greatest nontaxable benefits) until such plan would not be treated as a discriminatory employee benefit plan if such reduced benefits were taken into account.

"(3) Plans of same type.—In computing the excess benefit with respect to any benefit, there shall be taken into account all plans of the employer of the same type.

"(4) Nontaxable benefits.—For purposes of this subsection, the term 'nontaxable benefit' means any benefit provided under a plan to which this section applies which (without regard to subsection (a)(1)) is excludable from gross income under this chapter.

"(c) Discriminatory Employee Benefit Plan.—For purposes of this section, the term 'discriminatory employee benefit plan' means any statutory employee benefit plan unless such plan meets the—

"(1) eligibility requirements of subsection (d), and

"(2) benefit requirements of subsection (e).

"(d) Eligibility Requirements.—

"(1) In general.—A plan meets the eligibility requirements of this subsection for any plan year if—

"(A) at least 90 percent of all employees who are not highly compensated employees—

"(i) are eligible to participate in such plan (or in any other plan of the employer of the same type), and

"(ii) would (if they participated) have available under such plans an employer-provided benefit which is at least 50 percent of the largest employer-provided benefit available under all such plans of the employer to any highly compensated employee,

"(B) at least 50 percent of the employees eligible to participate in such plan are not highly compensated employees, and

"(C) such plan does not contain any provision relating to eligibility to participate which (by its terms or otherwise) discriminates in favor of highly compensated employees.

"(2) Alternative eligibility percentage test.—A plan shall be treated as meeting the requirements of paragraph (1)(B) if—

"(A) the percentage determined by dividing the number of highly compensated employees eligible to participate in the plan by the total number of highly compensated employees, does not exceed

"(B) the percentage similarly determined with respect to employees who are not highly compensated employees.

"(e) Benefit Requirements.—

"(1) In general.—A plan meets the benefit requirements of this subsection for any plan year if the average employer-provided benefit received by employees other than highly compensated employees under all plans of the employer of the same type is at least 75 percent of the average employer-provided benefit received by highly compensated employees under all plans of the employer of the same type.

"(2) Average employer-provided benefit.—For purposes of this subsection, the term 'average employer-provided benefit' means, with respect to highly compensated employees, an amount equal to—

"(A) the aggregate employer-provided benefits received by highly compensated employees under all plans of the type being tested, divided by

"(B) the number of highly compensated employees (whether or not covered under such plans).

The average employer-provided benefit with respect to employees other than highly compensated employees shall be determined in the same manner as the average employer-provided benefit for highly compensated employees.

"(f) Special Rule Where Health or Group-Term Plan Meets 80-Percent Coverage Test.—If at least 80 percent of the employees who are not highly compensated employees are covered under a health plan or group-term life insurance plan during the plan year, such plan shall be treated as meeting the requirements of subsections (d) and (e) for such year. The preceding sentence shall not apply if the plan does not meet the requirements of subsection (d)(1)(C) (relating to nondiscriminatory provisions).

"(g) Operating Rules.—

"(1) Aggregation of comparable health plans.—In the case of health plans maintained by an employer—

"(A) In general.—An employer may treat a group of comparable plans as 1 plan for purposes of applying subsections (d)(1)(B), (d)(2) and (f).

"(B) Comparable plans.—For purposes of subparagraph (A), a group of comparable plans is any group (selected by the employer) of plans of the same type if the smallest employer-provided benefit available to any participant in any such plan is at least 95 percent of the largest employer-provided benefit available to any participant in any such plan.

"(2) Special rules for applying benefit requirements to health plans.—

"(A) Election.—For purposes of determining whether the requirements of subsection (e) are met with respect to health plans, the employer may elect—

"(i) to disregard any employee if such employee and his spouse and dependents (if any) are covered by a

health plan providing core benefits maintained by another employer, and

"(ii) to apply subsection (e) separately with respect to coverage of spouses or dependents by such plans and to take into account with respect to such coverage only employees with a spouse or dependents who are not covered by a health plan providing core benefits maintained by another employer.

"(B) SWORN STATEMENTS.—Any employer who elects the application of subparagraph (A) shall obtain and maintain, in such manner as the Secretary may prescribe, adequate sworn statements to demonstrate whether individuals have—

"(i) a spouse or dependents, and

"(ii) core health benefits under a plan of another employer.

The Secretary shall provide a method for meeting the requirements of this subparagraph through the use of valid sampling techniques.

"(C) PRESUMPTION WHERE NO STATEMENT.—In the absence of a statement described in subparagraph (B)—

"(i) an employee who is not a highly compensated employee shall be treated—

"(I) as not covered by another plan of another employer providing core benefits, and

"(II) as having a spouse and dependents not covered by another plan of another employer providing core benefits, and

"(ii) a highly compensated employee shall be treated—

"(I) as covered by another plan of another employer providing core benefits, and

"(II) as not having a spouse or dependents.

"(D) CERTAIN INDIVIDUALS MAY NOT BE DISREGARDED.—In the case of a highly compensated employee who receives employer-provided benefits under all health plans of the employer which are more than 133⅓ percent of the average employer-provided benefit under such plan for employees other than highly compensated employees, the employer may not disregard such employee, or his spouse or dependents for purposes of clause (i) or (ii) of subparagraph (A).

"(3) EMPLOYER-PROVIDED BENEFIT.—For purposes of this section—

"(A) IN GENERAL.—Except as provided in subsection (k), an employee's employer-provided benefit under any statutory employee benefit plan is—

"(i) in the case of any health or group-term life insurance plan, the value of the coverage, or

"(ii) in the case of any other plan, the value of the benefits,

provided during the plan year to or on behalf of such employee to the extent attributable to contributions made by the employer.

"(B) SPECIAL RULE FOR HEALTH PLANS.—The value of the coverage provided by any health plan shall be determined under procedures prescribed by the Secretary which shall—

"(i) set forth the values of various standard types of coverage involving a representative group, and

"(ii) provide for adjustments to take into account the specific coverage and group involved.

"(C) SPECIAL RULE FOR GROUP-TERM LIFE PLANS.—

"(i) IN GENERAL.—Except as provided in clause (ii), in determining the value of coverage under a group-term life insurance plan, the amount taken into account for any employee shall be based on the cost of the insurance determined under section 79(c) for an employee who is age 40.

"(ii) EXCESS BENEFIT.—For purposes of subsection (b), the excess benefit with respect to coverage under a group-term life insurance plan shall be equal to the greater of—

"(I) the cost of such excess benefit (expressed as dollars of coverage) determined without regard to section 79(c), or

"(II) such cost determined with regard to section 79(c).

"(D) SALARY REDUCTIONS.—Except for purposes of subsections (d)(1)(A)(ii) and (j)(5), any salary reduction shall be treated as an employer-provided benefit.

"(4) ELECTION TO TEST PLANS OF DIFFERENT TYPES TOGETHER.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the employer may elect to treat all plans of the types specified in such election as plans of the same type for purposes of applying subsection (e).

"(B) EXCEPTION FOR HEALTH PLANS.—Subparagraph (A) shall not apply for purposes of determining whether any health plan meets the requirements of subsection (e); except that benefits provided under health plans which meet such requirements may be taken into account in determining whether plans of other types meet the requirements of subsection (e).

"(5) SEPARATE LINE OF BUSINESS EXCEPTION.—If, under section 414(r), an employer is treated as operating separate lines of business for a year, the employer may apply the preceding provisions of this section separately with respect to employees in each such separate line of business. The preceding sentence shall not apply to any plan unless such plan is available to a group of employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of highly compensated employees.

"(6) SPECIAL RULE FOR APPLYING ELIGIBILITY REQUIREMENTS AND 80-PERCENT TEST TO HEALTH PLANS.—For purposes of determining whether the requirements of subsection (d)(1)(A)(ii) or of subsection (f) are met with respect to health plans, the employer may elect—

"(A) to apply this section separately with respect to coverage of spouses and dependents by such plans, and

"(B) to take into account with respect to such coverage only those employees with a spouse or dependent (determined under rules similar to the rules of paragraphs (2) (B) and (C)).

"(h) EXCLUDED EMPLOYEES.—

"(1) IN GENERAL.—The following employees shall be excluded from consideration under this section:

"(A) Employees who have not completed 1 year of service (or in the case of core benefits under a health plan, 6 months of service). An employee shall be excluded from consideration until the 1st day of the 1st month beginning after completion of the period of service required under the preceding sentence.

"(B) Employees who normally work less than 17-1/2 hours per week.

"(C) Employees who normally work during not more than 6 months during any year.

"(D) Employees who have not attained age 21.

"(E) Employees who are included in a unit of employees covered by an agreement which the Secretary finds to be a collective bargaining agreement between employee representatives and 1 or more employers if there is evidence that the type of benefits provided under the plan was the subject of good faith bargaining between the employee representatives and such employer or employers.

"(F) Employees who are nonresident aliens and who receive no earned income (within the meaning of section 911(d)(2)) from the employer which constitutes income from sources within the United States (within the meaning of section 861(a)(3)).

Subparagraphs (A), (B), (C), and (D) shall be applied by substituting a shorter period of service, smaller number of hours or months, or lower age specified in the plan for the period of service, number of hours or months, or age (as the case may be) specified in such subparagraph.

"(2) CERTAIN EXCLUSIONS NOT TO APPLY IF EXCLUDED EMPLOYEES COVERED.—Except to the extent provided in regulations, employees shall not be excluded from consideration under any subparagraph of paragraph (1) (other than subparagraph (F)) unless no employee described in such subparagraph (determined with regard to the last sentence of paragraph (1)) is eligible under the plan.

"(3) EXCLUSION MUST APPLY TO ALL PLANS.—

"(A) IN GENERAL.—An exclusion shall apply under any subparagraph of paragraph (1) (other than subparagraph (F) thereof) only if the exclusion applies to all statutory employee benefit plans of the employer of the same type. In the case of a cafeteria plan, all benefits under the cafeteria plan shall be treated as provided under plans of the same type.

"(B) Exception.—Subparagraph (A) shall not apply to any difference in waiting periods for core and noncore benefits provided by health plans.

"(4) Exception for separate line of business.—If any line of business is treated separately under subsection (h)(5), then paragraphs (2) and (3) shall be applied separately to such line of business.

"(5) Requirements may be met separately with respect to excluded group.—Notwithstanding paragraphs (2) and (3), if employees do not meet minimum age or service requirements described in paragraph (1) (without regard to the last sentence thereof) and are covered under a plan of the employer which meets the requirements of this section separately with respect to such employees, such employees may be excluded from consideration in determining whether any plan of the employer meets the requirements of this section.

"(i) Statutory Employee Benefit Plan.—For purposes of this section—

"(1) In general.—The term 'statutory employee benefit plan' means—

"(A) an accident or health plan (within the meaning of section 105(e)), and

"(B) any plan of an employer for providing group-term life insurance (within the meaning of section 79).

"(2) Employer may elect to treat other plans as statutory employee benefit plan.—An employer may elect to treat any of the following plans as statutory employee benefit plans:

"(A) A qualified group legal services plan (within the meaning of section 120(b)).

"(B) An educational assistance program (within the meaning of section 127(b)).

"(C) A dependent care assistance program (within the meaning of section 129(d)).

An election under this paragraph with respect to any plan shall apply with respect to all plans of the same type as such plan.

"(3) Plans of the same type.—2 or more plans shall be treated as of the same type if such plans are described in the same subparagraph of paragraph (1) or (2).

"(j) Other Definitions and Special Rules.—For purposes of this section—

"(1) Highly compensated employee.—The term 'highly compensated employee' has the meaning given such term by section 414(q).

"(2) Health plan.—The term 'health plan' means any plan described in paragraph (1)(A) of subsection (i).

"(3) Treatment of former employees.—Except to the extent provided in regulations, this section shall be applied separately to former employees under requirements similar to the requirements that apply to employees.

"(4) Group-term life insurance plans.—

"(A) In general.—Any group-term life insurance plan shall not be treated as 2 or more separate plans merely because the amount of life insurance under the plan on behalf of employees bears a uniform relationship to the

compensation (within the meaning of section 414(s)) of such employees.

"(B) LIMITATION ON COMPENSATION.—For purposes of subparagraph (A), compensation in excess of the amount applicable under section 401(a)(17) shall not be taken into account.

"(C) LIMITATION.—This paragraph shall not apply to any plan if such plan is combined with plans of other types pursuant to an election under subsection (g)(4).

"(5) SPECIAL RULE FOR EMPLOYEES WORKING LESS THAN 30 HOURS PER WEEK.—Any health plan shall not fail to meet the requirements of this section merely because the employer-provided benefit is proportionately reduced for employees who normally work less than 30 hours per week. The preceding sentence shall apply only where the average work week of employees who are not highly compensated employees is 30 hours or more.

"(6) TREATMENT OF SELF-EMPLOYED INDIVIDUALS.—In the case of a statutory employee benefit plan described in subparagraph (A), (B), or (C) of subsection (i)(2)—

"(A) TREATMENT AS EMPLOYEE, ETC.—The term 'employee' includes any self-employed individual (as defined in section 401(c)(1)), and the term 'compensation' includes such individual's earned income (as defined in section 401(c)(2)).

"(B) EMPLOYER.—An individual who owns the entire interest in an unincorporated trade or business shall be treated as his own employer. A partnership shall be treated as the employer of each partner who is treated as an employee under subparagraph (A).

"(7) CERTAIN PLANS TREATED AS MEETING OTHER NONDISCRIMINATION REQUIREMENTS.—If an employer makes an election under subsection (i)(2) to have this section apply to any plan and such plan meets the requirements of this section, such plan shall be treated as meeting any other nondiscrimination requirement imposed on such plan (other than any requirement under section 120(c)(3), 127(b)(3), or 129(d)(4)).

"(8) SPECIAL RULES FOR CERTAIN DISPOSITIONS OR ACQUISITIONS.—

"(A) IN GENERAL.—If a person becomes, or ceases to be, a member of a group described in subsection (b), (c), (m), or (o) of section 414, then the requirements of this section shall be treated as having been met during the transition period with respect to any plan covering employees of such person or any other member of such group if—

"(i) such requirements were met immediately before each such change, and

"(ii) the coverage under such plan is not significantly changed during the transition period (other than by reason of the change in members of a group).

"(B) TRANSITION PERIOD.—For purposes of subparagraph (A), the term 'transition period' means the period—

"(i) beginning on the date of the change in members of a group, and

"(ii) ending on the last day of the 1st plan year beginning after the date of such change.

"(9) COORDINATION WITH MEDICARE, ETC.—If a plan may be coordinated with health benefits provided under any Federal, State, or foreign law or under any other health plan covering the employee or family member of the employee, such plan shall not fail to meet the requirements of this section with respect to health benefits merely because the amount of such benefits provided to any employee or family member of any employee are coordinated in a manner which does not discriminate in favor of highly compensated employees.

"(10) DISABILITY BENEFITS.—

"(A) IN GENERAL.—If a plan may be coordinated with disability benefits provided under any Federal, State, or foreign law or under any other plan covering the employee, such plan shall not fail to meet the requirements of this section with respect to disability benefits merely because the amount of such benefits provided to an employee are coordinated in a manner which does not discriminate in favor of highly compensated employees.

"(B) CERTAIN DISABILITY PLANS EXEMPT FROM NONDISCRIMINATION RULES.—Subsection (a) shall not apply to any disability coverage other than disability coverage the benefits of which are excludable from gross income under section 105(b) or (c).

"(11) SEPARATE APPLICATION IN THE CASE OF OPTIONS.—Each option or different benefit shall be treated as a separate plan.

"(k) REQUIREMENT THAT PLAN BE IN WRITING, ETC.—

"(1) IN GENERAL.—Notwithstanding any provision of part III of this subchapter, gross income of an employee shall include an amount equal to such employee's employer-provided benefit for the taxable year under an employee benefit plan to which this subsection applies unless, except to the extent provided in regulations—

"(A) such plan is in writing,

"(B) the employees' rights under such plan are legally enforceable,

"(C) employees are provided reasonable notification of benefits available in the plan,

"(D) such plan is maintained for the exclusive benefit of employees, and

"(E) such plan was established with the intention of being maintained for an indefinite period of time.

Such inclusion shall be in lieu of any inclusion under subsection (a) with respect to such plan.

"(2) PLANS TO WHICH SUBSECTION APPLIES.—This subsection shall apply to—

"(A) any statutory employee benefit plan,

"(B) a qualified tuition reduction program (within the meaning of section 117(d)),

"(C) a cafeteria plan (within the meaning of section 125),

"(D) a fringe benefit program providing no-additional-cost services, qualified employee discounts, or employer-operated eating facilities which are excludable from gross income under section 132, and

"(E) a plan to which section 505 applies.

"(3) SPECIAL RULE FOR DETERMINING INCLUSION.—For purposes of paragraph (1), an employee's employer-provided benefit shall be the value of the benefits provided to the employee.

"(4) PLANS TO WHICH CONTRIBUTIONS ARE MADE BY MORE THAN 1 EMPLOYER.—For purposes of paragraph (1)(D), in the case of a plan to which contributions are made by more than 1 employer, each employer shall be treated as employing employees of all other employers.

"(l) REPORTING REQUIREMENTS.—

"(1) IN GENERAL.—If an employee of an employer maintaining a plan is required to include any amount in gross income under this section for any plan year ending with or within a calendar year, the employer shall separately include such amount on the statement which the employer is required to provide the employee under section 6051(a) (and any statement required to be furnished under section 6051(d)).

"(2) PENALTY.—

"For penalty for failing to report, see section 6652(l).

"(m) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing for appropriate adjustments in case of individuals not employees of the employer throughout the plan year."

(b) PENALTY FOR FAILING TO REPORT.—Section 6652 (relating to failure to file information returns, registration statements, etc.) is amended by redesignating subsection (l) as subsection (m) and by inserting after subsection (k) the following new subsection:

"(l) INFORMATION WITH RESPECT TO INCLUDABLE EMPLOYEE BENEFITS.—

"(1) IN GENERAL.—In the case of each failure to include any amount on any statement under section 6051(a) or 6051(d) which is required to be so included under section 89(l), there shall be paid, on notice and demand of the Secretary and in the same manner as tax, the amount determined under paragraph (2).

"(2) AMOUNT OF ADDITIONAL TAX.—The amount determined under this paragraph shall be equal to the product of—

"(A) the highest rate of tax imposed by section 1 for taxable years beginning in the calendar year to which the return or statement relates, multiplied by

"(B) the employer-provided benefit (within the meaning of section 89 without regard to subsection (g)(3) thereof) with respect to the employee to whom such failure relates.

"(3) REASONABLE CAUSE EXCEPTION.—Paragraph (1) shall not apply to any failure if it is shown that such failure is due to reasonable cause.

"(4) COORDINATION WITH OTHER PENALTIES.—Any penalty under this subsection shall be in addition to any other penalty under this section or section 6678 with respect to any failure.

"(5) ONLY 1 ADDITION PER EMPLOYEE PER YEAR.—Paragraph (1) shall be applied only once if there is more than 1 failure with respect to any amount.

(c) REPEAL OF CERTAIN EXISTING NONDISCRIMINATION RULES.—

(1) DISCRIMINATORY GROUP-TERM LIFE INSURANCE PLANS.—Subsection (d) of section 79 is amended to read as follows:

"(d) NONDISCRIMINATION REQUIREMENTS.—In the case of a group-term life insurance plan which is a discriminatory employee benefit plan, subsection (a)(1) shall apply only to the extent provided in section 89."

(2) DISCRIMINATORY SELF-INSURED MEDICAL EXPENSE REIMBURSEMENT PLANS.—Section 105 (relating to amounts received under accident and health plans) is amended by striking out subsection (h) and by redesignating subsection (i) as subsection (h).

(3) QUALIFIED GROUP LEGAL SERVICES PLANS.—Section 120(b) (defining qualified group legal services plan) is amended to read as follows:

"(b) QUALIFIED GROUP LEGAL SERVICES PLAN.—For purposes of this section, a qualified group legal services plan is a separate plan of an employer—

"(1) under which the employer provides specified personal legal services to employees (or their spouses or dependents) through the prepayment of, or the provision in advance for, any portion of the legal fees for such services, and

"(2) which meets the requirements of subsection (c) and section 89(k)."

(4) EDUCATIONAL ASSISTANCE PROGRAMS.—Section 127(b) (relating to educational assistance programs) is amended—

(A) by striking out paragraph (1) and inserting in lieu thereof the following new paragraph:

"(1) IN GENERAL.—For purposes of this section, an educational assistance program is a plan of an employer—

"(A) under which the employer provides employees with educational assistance, and

"(B) which meets the requirements of paragraphs (2) through (5) and section 89(k).", and

(B) by striking out paragraph (6) thereof.

(5) DEPENDENT CARE ASSISTANCE PROGRAMS.—Section 129(d) (relating to dependent care assistance program) is amended—

(A) by striking out paragraph (1) and inserting in lieu thereof the following new paragraph:

"(1) IN GENERAL.—For purposes of this section, a dependent care assistance program is a plan of an employer—

"(A) under which the employer provides employees with dependent care assistance, and

"(B) which meets the requirements of paragraphs (2) through (6) and section 89(k).", and

(B) by striking out paragraph (6) thereof, and redesignating paragraph (7) as paragraph (6).

(d) COORDINATION WITH CAFETERIA PLANS.—

(1) IN GENERAL.—Section 125 (relating to cafeteria plans) is amended to read as follows:

"SEC. 125. CAFETERIA PLANS.

"(a) GENERAL RULE.—In the case of a cafeteria plan—

"(1) amounts shall not be included in gross income of a participant in such plan solely because, under the plan, the participant may choose among the benefits of the plan, and

"(2) if the plan fails to meet the requirements of subsection (b) for any plan year—

"(A) paragraph (1) shall not apply, and

"(B) notwithstanding any other provision of part III of this subchapter, any qualified benefits received under such cafeteria plan by a highly compensated employee for such plan year shall be included in the gross income of such employee for the taxable year with or within which such plan year ends.

"(b) PROHIBITION AGAINST DISCRIMINATION AS TO ELIGIBILITY TO PARTICIPATE.—

"(1) HIGHLY COMPENSATED EMPLOYEES.—A plan shall be treated as failing to meet the requirements of this subsection unless the plan is available to a group of employees as qualify under a classification set up by the employer and which the Secretary find not to be discriminatory in favor of highly compensated employees.

"(2) KEY EMPLOYEES.—In the case of a key employee (within the meaning of section 416(i)(1)), a plan shall be treated as failing to meet the requirements of this subsection if the qualified benefits provided to key employees under the plan exceed 25 percent of the aggregate of such benefits provided for all employees under the plan. For purposes of the preceding sentence, qualified benefits shall be determined without regard to the last sentence of subsection (e).

"(3) EXCLUDABLE EMPLOYEES.—For purposes of this subsection, there may be excluded from consideration employees who may be excluded from consideration under section 89(h).

"(c) CAFETERIA PLAN DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'cafeteria plan' means a plan which meets the requirements of section 89(k) and under which—

"(A) all participants are employees, and

"(B) the participants may choose—

"(i) among 2 or more benefits consisting of cash and qualified benefits, or

"(ii) among 2 or more qualified benefits.

"(2) DEFERRED COMPENSATION PLANS EXCLUDED.—

"(A) IN GENERAL.—The term 'cafeteria plan' does not include any plan which provides for deferred compensation.

"(B) EXCEPTION FOR CASH AND DEFERRED ARRANGEMENTS.—Subparagraph (A) shall not apply to a profit-sharing or stock bonus plan which includes a qualified cash or deferred arrangement (as defined in section 401(k)(2)) to the extent of amounts which a covered employee may elect to have the employer pay as contributions to a trust under such plan on behalf of the employee.

"(C) EXCEPTION FOR CERTAIN PLANS MAINTAINED BY EDUCATIONAL INSTITUTIONS.—Subparagraph (A) shall not apply to a plan maintained by an educational organization described in section 170(b)(1)(A)(ii) to the extent of amounts

which a covered employee may elect to have the employer pay as contributions for post-retirement group life insurance if—

"(i) all contributions for such insurance must be made before retirement, and

"(ii) such life insurance does not have a cash surrender value at any time.

For purposes of section 79, any life insurance described in the preceding sentence shall be treated as group-term life insurance.

"(d) HIGHLY COMPENSATED EMPLOYEE.—For purposes of this section, the term 'highly compensated employee' has the meaning given such term by section 414(q).

"(e) QUALIFIED BENEFITS DEFINED.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified benefit' means any benefit which, with the application of subsection (a), is not includible in the gross income of the employee by reason of an express provision of this chapter (other than section 117, 124, 127, or 132).

"(2) CERTAIN BENEFITS INCLUDED.—The term 'qualified benefits' includes—

"(A) any group-term life insurance which is includible in gross income only because it exceeds the dollar limitation of section 79, and

"(B) any other benefit permitted under regulations.

"(f) COLLECTIVELY BARGAINED PLAN NOT CONSIDERED DISCRIMINATORY.—For purposes of this section, a plan shall not be treated as discriminatory if the plan is maintained under an agreement which the Secretary finds to be a collective bargaining agreement between employee representatives and one or more employers.

"(g) CROSS REFERENCES.—

"For reporting and recordkeeping requirements, see section 6039D."

(2) APPLICATION WITH EMPLOYMENT TAXES.—

(A) Section 3121(a)(5) is amended by striking out "or" at the end of subparagraph (E), by inserting "or" at the end of subparagraph (F), and by inserting after subparagraph (F) the following new subparagraph:

"(G) under a cafeteria plan (within the meaning of section 125),"

(B) Section 3306(b)(5) is amended by striking out "or" at the end of subparagraph (E), by inserting "or" at the end of subparagraph (F), and by inserting after subparagraph (F) the following new subparagraph:

"(G) under a cafeteria plan (within the meaning of section 125),"

(C) Section 209(e) of the Social Security Act is amended by inserting before the semicolon at the end thereof the following: ", or (9) under a cafeteria plan (within the meaning of section 125 of the Internal Revenue Code of 1986)".

(e) SPECIAL RULES FOR CONTROLLED GROUPS, ETC.—

(1) IN GENERAL.—Section 414 is amended by adding at the end thereof the following new subsection:

"(t) Application of Controlled Group Rules to Certain Employee Benefits.—

"(1) In general.—All employees who are treated as employed by a single employer under subsection (b), (c), or (m) of section 414 shall be treated as employed by a single employer for purposes of an applicable section. The provisions of subsection (o) of section 414 shall apply with respect to the requirements of an applicable section.

"(2) Applicable section.—For purposes of this subsection, the term 'applicable section' means section 79, 89, 106, 117(d), 120, 125, 127, 129, 132, 274(j), or 505."

(2) Conforming amendments.—

(A) Section 132(g) (relating to special rules relating to employer) is amended to read as follows:

"(g) Reciprocal Agreements.—For purposes of paragraph (1) of subsection (a), any service provided by an employer to an employee of another employer shall be treated as provided by the employer of such employee if—

"(1) such service is provided pursuant to a written agreement between such employers, and

"(2) neither of such employers incurs any substantial additional costs (including foregone revenue) in providing such service or pursuant to such agreement."

(B) Paragraph (4) of section 505(b) (relating to aggregation rules) is amended to read as follows:

"(4) Aggregation rules.—At the election of the employer, 2 or more plans of such employer may be treated as 1 plan for purposes of this subsection."

(f) Benefits Test for Dependent Care Assistance Programs.—Section 129(d) (relating to dependent care assistance program) is amended by adding at the end thereof the following new paragraph:

"(8) Benefits.—

"(A) In general.—A plan meets the requirements of this paragraph if the average benefits provided to employees who are not highly compensated employees is at least 55 percent of the average benefits provided to highly compensated employees.

"(B) Salary reduction agreements.—For purposes of subparagraph (A), in the case of any benefits provided through a salary reduction agreement, there shall be disregarded any employees whose compensation (within the meaning of section 415(q)(7)) is less than $25,000."

(g) Definition of Excludable Employee.—

(1) Section 120(c)(2) is amended by striking out the last sentence thereof and inserting in lieu thereof "For purposes of this paragraph, there may be excluded from consideration employees who may be excluded from consideration under section 89(h)."

(2) Section 117(d) is amended by adding at the end thereof the following new paragraph:

"(4) Exclusion of certain employees.—For purposes of this subsection, there may be excluded from consideration employees who may be excluded from consideration under section 89(h)."

(3) Section 127(b)(2) is amended by striking out the last sentence thereof and inserting in lieu thereof: "For purposes of this paragraph, there may be excluded from consideration employees who may be excluded from consideration under section 89(h)."

(4) Section 129(d)(3) is amended by striking out the last sentence thereof and inserting in lieu thereof: "For purposes of this paragraph, there may be excluded from consideration employees who may be excluded from consideration under section 89(h)."

(5) Section 132(h)(1) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph and subsection (e), there may be excluded from consideration employees who may be excluded from consideration under section 89(h)."

(6) Paragraph (2) of section 505(b) is amended to read as follows:

"(2) Exclusion of certain employees.—For purposes of paragraph (1), there may be excluded from consideration employees who may be excluded from consideration under section 89(h)."

(h) Reporting Requirements.—

(1) In general.—Section 6039D(d) is amended to read as follows:

"(d) Definitions.—For purposes of this section—

"(1) Specified fringe benefit plan.—The term 'specified fringe benefit plan' means any plan under section 79, 105, 106, 120, 125, 127, or 129.

"(2) Applicable exclusion.—The term 'applicable exclusion' means, with respect to any specified fringe benefit plan, the section specified under paragraph (1) under which benefits under such plan are excludable from gross income."

(2) Information required to be reported.—Section 6039D(a) is amended by striking out "and" at the end of paragraph (4), by striking out the period at the end of paragraph (5) and inserting in lieu thereof ", and", and by inserting after paragraph (5) the following new paragraph:

"(6) the number of highly compensated employees among the employees described in paragraphs (1), (2), and (3)."

(3) Additional information.—Section 6039B(c) is amended by adding at the end thereof the following new sentence: "The Secretary may require returns under this subsection only from a representative group of employers."

(i) Conforming Amendments to Section 414(n).—

(1) Paragraph (1) of section 414(n) is amended by striking out "pension requirements" and inserting in lieu thereof "requirements".

(2) Subparagraph (B) of section 414(n)(2) is amended by inserting "(6 months in the case of core health benefits) after "1 year".

(3) Paragraph (3) of section 414(n) is amended—

(A) by striking out "Pension requirements" and inserting in lieu thereof "Requirements",

(B) by striking out "pension requirements" and inserting in lieu thereof "requirements", and

(C) by striking out "and" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(C) sections 79, 89, 106, 117(d), 120, 125, 127, 129, 132, 274(j), and 505."

(j) Other Conforming Amendments.—

(1) The table of sections for part II of subchapter B of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 89. Benefits provided under certain employee benefit plans."

(2) Subsection (a) of section 106 (relating to contributions by employer to accident and health plans) is amended to read as follows:

"(a) In General.—Gross income of an employee does not include employer-provided coverage under an accident or health plan."

(3) Section 505(b) is amended by adding at the end thereof the following new paragraph:

"(6) Compensation.—For purposes of this subsection, the term 'compensation' has the meaning given such term by section 414(s)."

(k) Effective Dates.—

(1) In general.—The amendments made by this section shall apply to years beginning after the later of—

(A) December 31, 1987, or

(B) the earlier of—

(i) the date which is 3 months after the date on which the Secretary of the Treasury or his delegate issues such regulations as are necessary to carry out the provisions of section 89 of the Internal Revenue Code of 1986 (as added by this section), or

(ii) December 31, 1988.

(2) Special rule for collective bargaining plan.—In the case of a plan maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers ratified before March 1, 1986, the amendments made by this section shall not apply to employees covered by such an agreement in years beginning before the earlier of—

(A) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof after February 28, 1986), or

(B) January 1, 1991.

A plan shall not be required to take into account employees to which the preceding sentence applies for purposes of applying section 89 of the Internal Revenue Code of 1986 (as added by this section) to employees to which the preceding sentence does not apply for any year preceding the year described in the preceding sentence.

(3) Exception for certain group-term insurance plans.—In the case of a plan described in section 223(d)(2) of the Tax Reform Act of 1984, such plan shall be treated as meeting the requirements of section 89 of the Internal Revenue Code of 1986 (as added by this section) with respect to individuals described

in section 223(d)(2) of such Act. An employer may elect to disregard such individuals in applying section 89 of such Code (as so added) to other employees of the employer.

(4) Special rule for church plans.—In the case of a church plan (within the meaning of section 414(e)(3) of the Internal Revenue Code of 1986) maintaining an insured accident and health plan, the amendments made by this section shall apply to years beginning after December 31, 1988.

(5) Cafeteria plans.—The amendments made by subsection (d)(2) shall apply to taxable years beginning after December 31, 1983.

PART II—OTHER PROVISIONS

SEC. 1161. DEDUCTIBILITY OF HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.

(a) General Rule.—Section 162 (relating to trade or business expenses), as amended by this Act, is amended by redesignating subsection (n) as subsection (m) and by inserting after subsection (l) the following new subsection:

"(m) Special Rules for Health Insurance Costs of Self-Employed Individuals.—

"(1) In general.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to 25 percent of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, his spouse, and dependents.

"(2) Limitations.—

"(A) Dollar amount.—No deduction shall be allowed under paragraph (1) to the extent that the amount of such deduction exceeds the taxpayer's earned income (within the meaning of section 401(c)).

"(B) Required coverage.—Paragraph (1) shall not apply to any taxpayer for any taxable year unless coverage is provided under 1 or more plans meeting the requirements of section 89, treating such coverage as an employer-provided benefit.

"(C) Other coverage.—Paragraph (1) shall not apply to any taxpayer who is eligible to participate in any subsidized health plan maintained by any employer of the taxpayer or of the spouse of the taxpayer.

"(3) Coordination with medical deduction.—Any amount paid by a taxpayer for insurance to which paragraph (1) applies shall not be taken into account in computing the amount allowable to the taxpayer as a deduction under section 213(a).

"(4) Termination.—This subsection shall not apply to any taxable year beginning after December 31, 1989."

(b) Effective Date.—

(1) In general.—The amendment made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Transitional rule.—In the case of any year to which section 89 of the Internal Revenue Code of 1986 does not apply, section 162(m)(2)(B) of such Code shall be applied by substituting

any nondiscrimination requirements otherwise applicable for the requirements of section 89 of such Code.

(3) Assistance.—The Secretary of the Treasury or his delegate shall provide guidance to self-employed individuals to assist them in meeting the requirements of section 89 of the Internal Revenue Code of 1986 with respect to coverage required by the amendments made by this section.

EC. 1162. 2-YEAR EXTENSION OF EXCLUSIONS FOR EDUCATIONAL ASSISTANCE PROGRAMS AND GROUP LEGAL PLANS.

(a) Educational Assistance Programs.—

(1) Extension.—Subsection (d) of section 127 (relating to termination of exclusion for amounts received under educational assistance programs) is amended by striking out "1985" and inserting in lieu thereof "1987".

(2) Increase in amount.—Paragraph (2) of section 127(a) is amended by striking out "$5,000" each place it appears in the text and the heading thereof and inserting in lieu thereof "$5,250".

(b) Group Legal Plans.—Subsection (e) of section 120 (relating to rmination of exclusion for amounts received under qualified group gal services plans) is amended by striking out "1985" and insertig in lieu thereof "1987".

(c) Effective Dates.—

(1) Subsection (a).—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 1985.

(2) Subsection (b).—The amendment made by subsection (b) shall apply to years ending after December 31, 1985.

(3) Cafeteria plan with group legal benefits.—If, within 60 days after the date of the enactment of this Act, an employee elects under a cafeteria plan under section 125 of the Internal Revenue Code of 1986 coverage for group legal benefits to which section 120 of such Code applies, such election may, at the election of the taxpayer, apply to all legal services provided during 1986. The preceding sentence shall not apply to any plan which on August 16, 1986, offered such group legal benefits under such plan.

EC. 1163. $5,000 LIMIT ON DEPENDENT CARE ASSISTANCE EXCLUSION.

(a) General Rule.—Subsection (a) of section 129 (relating to deendent care assistance programs) is amended to read as follows:

"(a) Exclusion.—

"(1) In general.—Gross income of an employee does not include amounts paid or incurred by the employer for dependent care assistance provided to such employee if the assistance is furnished pursuant to a program which is described in subsection (d).

"(2) Limitation of exclusion.—The aggregate amount excluded from the gross income of the taxpayer under this section for any taxable year shall not exceed $5,000 ($2,500 in the case of a separate return by a married individual).

or purposes of the preceding sentence, marital status shall be deterined under the rules of paragraphs (3) and (4) of section 21(e)."

(b) Treatment of Onsite Facilities.—Subsection (e) of section 129 is amended by adding at the end thereof the following new paragraph:

"(8) Treatment of onsite facilities.—In the case of an onsite facility, except to the extent provided in regulations, the amount excluded with respect to any dependent shall be based on—

"(A) utilization, and

"(B) the value of the services provided."

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1164. TAX TREATMENT OF FACULTY HOUSING.

(a) In General.—Section 119 (relating to meals or lodging furnished for the convenience of the employer) is amended by adding at the end thereof the following new subsection:

"(d) Lodging Furnished by Certain Educational Institutions to Employees.—

"(1) In general.—In the case of an employee of an educational institution, gross income shall not include the value of qualified campus lodging furnished to such employee during the taxable year.

"(2) Exception in cases of inadequate rent.—Paragraph (1) shall not apply to the extent of the excess of—

"(A) the lesser of—

"(i) 5 percent of the appraised value (as of the close of the calendar year in which the taxable year begins) of the qualified campus lodging, or

"(ii) the average of the rentals paid by individuals (other than employees or students of the educational institution) during such calendar year for lodging provided by the educational institution which is comparable to the qualified campus lodging provided to the employee, over

"(B) the rent paid by the employee for the qualified campus lodging during such calendar year.

"(3) Qualified campus lodging.—For purposes of this subsection, the term 'qualified campus lodging' means lodging to which subsection (a) does not apply and which is—

"(A) located on, or in the proximity of, a campus of the educational institution, and

"(B) furnished to the employee, his spouse, and any of his dependents by or on behalf of such institution for use as a residence.

"(4) Educational institution.—For purposes of this paragraph, the term 'educational institution' means an institution described in section 170(b)(1)(A)(ii).".

(b) Effective Date.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1985.

SEC. 1165. LIMITATION ON ACCRUAL OF VACATION PAY.

(a) General Rule.—Paragraph (1) of section 463(a) (relating to accrual of vacation pay) is amended by striking out "and expected to be paid during the taxable year or within 12 months following the close of the taxable year" and inserting in lieu thereof "and

paid during the taxable year or within 8 1/2 months following the close of the taxable year".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

SEC. 1166. TREATMENT OF CERTAIN FULL-TIME LIFE INSURANCE SALESMEN.

(a) GENERAL RULE.—Paragraph (20) of section 7701(a) (defining employee) is amended by striking out "and 106" and inserting in lieu thereof "106, and 125".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 1985.

SEC. 1167. EXTENSION OF DUE DATE FOR STUDY OF WELFARE BENEFIT PLANS.

Section 560(b) of the Tax Reform Act of 1984 is amended by striking out "February 1, 1985" and inserting in lieu thereof "the date which is 1 year after the date of the enactment of the Tax Reform Act of 1986".

SEC. 1168. EXCLUSION FROM GROSS INCOME OF CERTAIN MILITARY BENEFITS.

(a) EXCLUSION FROM GROSS INCOME.—Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 134 as section 135 and by inserting after section 133 the following new section:

"SEC. 134. CERTAIN MILITARY BENEFITS.

"(a) GENERAL RULE.—Gross income shall not include any qualified military benefit.

"(b) QUALIFIED MILITARY BENEFIT.—For purposes of this section—

> *"(1) IN GENERAL.—The term 'qualified military benefit' means any allowance or in-kind benefit which—*
>
> > *"(A) is received by any member or former member of the uniformed services of the United States or any dependent of such member by reason of such member's status or service as a member of such uniformed services, and*
> >
> > *"(B) was excludable from gross income on September 9, 1986, under any provision of law or regulation thereunder which was in effect on such date (other than a provision of this title).*
>
> *"(2) NO OTHER BENEFIT TO BE EXCLUDABLE EXCEPT AS PROVIDED BY THIS TITLE.—Notwithstanding any other provision of law, no benefit shall be treated as a qualified military benefit unless such benefit—*
>
> > *"(A) is a benefit described in paragraph (1), or*
> >
> > *"(B) is excludable from gross income under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act.*
>
> *"(3) LIMITATIONS ON MODIFICATIONS.—*
>
> > *"(A) IN GENERAL.—Except as provided in subparagraph (B), no modification or adjustment of any qualified military benefit after September 9, 1986, under any provision of law or regulation described in paragraph (1) shall be taken into account.*

"(B) Exception for certain adjustments to cash benefits.—Subparagraph (A) shall not apply to any adjustment to any qualified military benefit payable in cash which—

"(i) is pursuant to a provision of law or regulation (as in effect on September 9, 1986), and

"(ii) is determined by reference to any fluctuation in cost, price, currency, or other similar index."

(b) The table of sections for part III of subchapter B of chapter 1 is amended by striking out the item relating to section 134 and inserting in lieu thereof the following new items:

"Sec. 134. Certain military benefits.
"Sec. 135. Cross references to other Acts."

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

Subtitle C—Changes Relating to Employee Stock Ownership Plans

SEC. 1171. REPEAL OF EMPLOYEE STOCK OWNERSHIP CREDIT.

(a) In General.—Section 41 (relating to employee stock ownership credit) is hereby repealed.

(b) Technical and Conforming Amendments.—

(1) Subsection (b) of section 38 is amended by striking out ", plus" at the end of paragraph (4), by striking out ", plus" at the end of paragraph (3) and inserting in lieu thereof a period, and by inserting "plus" at the end of paragraph (2).

(2) Subsection (d) of section 38 is amended—

(A) by striking out "196(a), and 404(i)" and inserting in lieu thereof "and 196(a)", and

(B) by striking out "41(a),".

(3) Subsection (c) of section 56 is amended by striking out the last sentence.

(4) Subparagraph (B) of section 108(b)(2) is amended by striking out the last sentence.

(5) Paragraph (21) of section 401(a) is hereby repealed.

(6) Subsection (i) of section 404 (relating to deductibility of unused portions of employee stock ownership credit) is hereby repealed.

(7)(A) Section 6699 (relating to assessable penalties relating to tax credit employee stock ownership plan) is hereby repealed.

(B) The table of sections for subchapter B of chapter 68 is amended by striking out the item relating to section 6699.

(c) Effective Date.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to compensation paid or accrued after December 31, 1986, in taxable years ending after such date.

(2) Sections 404(i) and 6699 to continue to apply to pre-1987 credits.—The provisions of sections 404(i) and 6699 of the Internal Revenue Code of 1986 shall continue to apply with respect to credits under section 41 of such Code attributable to

compensation paid or accrued before January 1, 1987 (or under section 38 of such Code with respect to qualified investment before January 1, 1983).

SEC. 1172. ESTATE TAX DEDUCTION FOR PROCEEDS FROM SALES OF EMPLOYER SECURITIES.

(a) In General.—Part IV of subchapter A of chapter 11 (relating to taxable estate) is amended by adding at the end thereof the following new section:

"SEC. 2057. SALES OF EMPLOYER SECURITIES TO EMPLOYEE STOCK OWNERSHIP PLANS OR WORKER-OWNED COOPERATIVES.

"(a) General Rule.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate an amount equal to 50 percent of the qualified proceeds of a qualified sale of employer securities.

"(b) Qualified Sale.—For purposes of this section, the term 'qualified sale' means any sale of employer securities by the executor of an estate to—

"(1) an employee stock ownership plan is described in section 4975(e)(7), or

"(2) an eligible worker-owned cooperative (within the meaning of section 1042(c)).

"(c) Qualified Proceeds.—For purposes of this section—

"(1) In general.—The term 'qualified proceeds' means the amount received by the estate from the sale of employer securities at any time before the date on which the return of the tax imposed by section 2001 is required to be filed (including any extensions).

"(2) Proceeds from certain securities not qualified.—The term 'qualified proceeds' shall not include the proceeds from the sale of any employer securities if such securities were received by the decedent—

"(A) in a distribution from a plan exempt from tax under section 501(a) which meets the requirements of section 401(a), or

"(B) as a transfer pursuant to an option or other right to acquire stock to which section 83, 422, 422A, 423, or 424 applies.

"(d) Written Statement Required.—

"(1) In general.—No deduction shall be allowed under subsection (a) unless the executor of the estate of the decedent files with the Secretary the statement described in paragraph (2).

"(2) Statement.—A statement is described in this paragraph if it is a verified written statement of—

"(A) the employer whose employees are covered by the plan described in subsection (b)(1), or

"(B) any authorized officer of the cooperative described in subsection (b)(2),

consenting to the application of section 4979A with respect to such employer or cooperative.

"(e) Employer Securities.—For purposes of this section, the term 'employer securities' has the meaning given such term by section 409(l).

"(f) TERMINATION.—This section shall not apply to any sale after December 31, 1991."

(b) CONFORMING AMENDMENTS.—

(1) Section 409(n)(1) is amended—

(A) by inserting "or section 2057" after "section 1042",

(B) by inserting "or any decedent if the executor of the estate of such decedent makes a qualified sale to which section 2057 applies," after "securities" in subparagraph (A)(i) thereof, and

(C) by inserting "or the decedent" after "taxpayer" in subparagraph (A)(ii) thereof.

(2) Section 4979A is amended—

(A) by inserting "or section 2057" after "section 1042" in subsection (b)(1) thereof, and

(B) by inserting "or section 2057(d)" after "section 1042(b)(3)(B)" in subsection (c) thereof.

(3) The table of sections for part IV of subchapter A of chapter 11 is amended by adding at the end thereof the following new item:

"Sec. 2057. Sales of employer securities to employee stock ownership plans or worker-owned cooperatives."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to sales after the date of the enactment of this Act with respect to which an election is made by the executor of an estate who is required to file the return of the tax imposed by the Internal Revenue Code of 1986 on a date (including extensions) after the date of the enactment of this Act.

SEC. 1173. PROVISIONS RELATING TO LOANS USED TO ACQUIRE EMPLOYER SECURITIES.

(a) DEDUCTION FOR DIVIDENDS PAID TO REPAY LOANS.—

(1) IN GENERAL.—Paragraph (2) of section 404(k) (relating to dividend paid deductions) is amended by striking out "or" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", or", and by inserting at the end thereof the following new subparagraph:

"(C) the dividend with respect to employer securities is used to make payments on a loan described in section 404(a)(9)."

(2) CONFORMING AMENDMENT.—Section 404(k) is amended by adding at the end thereof the following new sentence: "Any deduction under paragraph (2)(C) shall be allowable in the taxable year of the corporation in which the dividend is used to repay the loan described in such paragraph."

(b) SECURITIES ACQUISITION LOANS.—

(1) APPLICATION TO INTEREST RECEIVED BY RIC.—

(A) IN GENERAL.—Section 133(a) (relating to exclusion for interest on certain loans used to acquire employer securities) is amended by striking out "or" at the end of paragraph (2), by inserting "or" at the end of paragraph (3), and by adding at the end thereof the following new paragraph:

"(4) a regulated investment company (as defined in section 851),".

(B) Conforming amendment.—Section 852(b)(5) is amended by adding at the end thereof the following new subparagraph:

"(C) Interest on certain loans used to acquire employer securities.—For purposes of this paragraph—

"(i) 50 percent of the amount of any loan of the regulated investment company which qualifies as a securities acquisition loan (as defined in section 133) shall be treated as an obligation described in section 103(a), and

"(ii) 50 percent of the interest received on such loan shall be treated as interest excludable from gross income under section 103."

(2) Securities acquisition loan.—Section 133(b)(1) (defining securities acquisition loan) is amended to read as follows:

"(1) In general.—For purposes of this section, the term 'securities acquisition loan' means—

"(A) any loan to a corporation or to an employee stock ownership plan to the extent that the proceeds are used to acquire employer securities for the plan, or are used to refinance such a loan, or

"(B) any loan to a corporation to the extent that, within 30 days, employer securities are transferred to the plan in an amount equal to the proceeds of such loan and such securities are allocable to accounts of plan participants within 1 year of the date of such loan, except that this subparagraph shall not apply to any loan the commitment period of which exceeds 7 years.

For purposes of this paragraph, the term 'employer securities' has the meaning given such term by section 409(l)."

(c) Effective Dates.—

(1) Dividends.—The amendments made by subsection (a) shall apply to dividends paid in taxable years beginning after the date of the enactment of this Act.

(2) Subsection (b).—

(A) The amendments made by subsection (b)(1) shall apply to loans used to acquire employer securities after the date of the enactment of this Act, including loans used to refinance loans used to acquire employer securities before such date if such loans were used to acquire employer securities after May 23, 1984.

(B)(i) Section 133(b)(1)(A) of the Internal Revenue Code of 1986, as amended by subsection (b)(2), shall apply to any loan used to refinance a loan which—

(I) met the requirements of section 133(b)(1) (as in effect when such loan was entered into), and

(II) was used to acquire securities after July 18, 1984.

(ii) If a loan described in clause (i) has a term of greater than 7 years, clause (i) shall apply only to interest accruing on such loan during the first 7 years.

(C) Section 133(b)(1)(B) of the Internal Revenue Code of 1986, as added by subsection (b)(2), shall apply to loans incurred after the date of enactment of this Act.

SEC. 1174. REQUIREMENTS FOR EMPLOYEE STOCK OWNERSHIP PLANS.

(a) Distributions on Plan Terminations Permitted.—

(1) In general.—Paragraph (1) of section 409(d) (requiring that employer securities must stay in the plan) is amended by striking out "or separation from service" and inserting in lieu thereof "separation from service, or termination of the plan".

(2) Effective date.—The amendment made by this subsection shall apply to plan terminations after December 31, 1984.

(b) Distribution and Payment Requirements.—

(1) In general.—Section 409 (relating to qualifications for employee stock ownership plans) is amended by redesignating subsection (o) as subsection (p) and by inserting after subsection (n) the following new subsection:

"(o) Distribution and Payment Requirements.—A plan meets the requirements of this subsection if—

"(1) Distribution requirement.—

"(A) In general.—The plan provides that, unless the participant otherwise elects, the distribution of the participant's account balance in the plan will commence not later than 1 year after the close of the plan year—

"(i) in which the participant separates from service by reason of the attainment of normal retirement age under the plan, disability, or death, or

"(ii) which is the 5th plan year following the plan year in which the participant otherwise separates from service, except that this clause shall not apply if the participant is reemployed by the employer before such year.

"(B) Exception for certain financed securities.—For purposes of this subsection, the account balance of a participant shall not include any employer securities acquired with the proceeds of the loan described in section 404(a)(9) until the close of the plan year in which such loan is repaid in full.

"(C) Limited distribution period.—The plan provides that, unless the participant elects otherwise, the distribution of the participant's account balance will be in substantially equal periodic payments (not less frequently than annually) over a period not longer than the greater of—

"(i) 5 years, or

"(ii) in the case of a participant with an account balance in excess of $500,000, 5 years plus 1 additional year (but not more than 5 additional years) for each $100,000 or fraction thereof by which such balance exceeds $500,000.

"(2) Cost-of-living adjustment.—The Secretary shall adjust the dollar amounts under paragraph (1)(C) at the same time and in the same manner as under section 415(d)."

(2) Conforming amendments.—Sections 409(a)(3) is amended by striking out "and (h)" and inserting in lieu thereof "(h), and (o)".

(3) Effective date.—The amendments made by this subsection shall apply to distributions attributable to stock acquired after December 31, 1986.

(c) Put Option Requirements.—

(1) Payment requirement.—

(A) In general.—Subsection (h) of section 409 (relating to right to demand employer securities; put option) is amended by adding at the end thereof the following new paragraphs:

"(5) Payment requirement for total distribution.—If an employer is required to repurchase employer securities which are distributed to the employee as part of a total distribution, the requirements of paragraph (1)(B) shall be treated as met if—

"(A) the amount to be paid for the employer securities is paid in substantially equal periodic payments (not less frequently than annually) over a period beginning not later than 30 days after the exercise of the put option described in paragraph (4) and not exceeding 5 years, and

"(B) there is adequate security provided and reasonable interest paid on the unpaid amounts referred to in subparagraph (A).

For purposes of this paragraph, the term 'total distribution' means the distribution within 1 taxable year to the recipient of the balance to the credit of the recipient's account.

"(6) Payment requirement for installment distributions.—If an employer is required to repurchase employer securities as part of an installment distribution, the requirements of paragraph (1)(B) shall be treated as met if the amount to be paid for the employer securities is paid not later than 30 days after the exercise of the put option described in paragraph (4)."

(B) Effective date.—The amendment made by this paragraph shall apply to distributions attributable to stock acquired after December 31, 1986, except that a plan may elect to have such amendment apply to all distributions after the date of the enactment of this Act.

(2) Put option requirement extended to stock bonus plans.—

(A) In general.—Section 401(a)(23) is amended to read as follows:

"(23) A stock bonus plan shall not be treated as meeting the requirements of this section unless such plan meets the requirements of subsections (h) and (o) of section 409, except that in applying section 409(h) for purposes of this paragraph, the term 'employer securities' shall include any securities of the employer held by the plan."

(B) Effective date.—The amendment made by this paragraph shall apply to distributions attributable to stock acquired after December 31, 1986.

(d) Nondiscrimination Requirements.—

(1) In general.—Subparagraph (A) of section 415(c)(6) is amended by striking out "the group of employees consisting of officers, shareholders owning more than 10 percent of the employer's stock (determined under subparagraph (B)(iv)), or employees described in subparagraph (B)(iii)" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(2) Conforming amendments.—

(A) Subparagraph (B) of section 415(c)(6) is amended by striking out clauses (iii) and (iv) thereof.

(B) Subparagraph (C) of section 415(c)(6) is amended by striking out "the group of employees consisting of officers, shareholders owning more than 10 percent of the employer's stock (determined under subparagraph (B)(iv)), or employees described in subparagraph (B)(iii)" and inserting in lieu thereof "highly compensated employees (within the meaning of section 414(q))".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 1986.

SEC. 1175. ADDITIONAL QUALIFICATION REQUIREMENTS.

(a) ADDITIONAL QUALIFICATION REQUIREMENTS FOR EMPLOYEE STOCK OWNERSHIP PLANS.—

(1) IN GENERAL.—Subsection (a) of section 401 (relating to qualified pension, profit-sharing, and stock bonus plans), as amended by this Act, is amended by inserting after paragraph (27) the following new paragraph:

"(28) ADDITIONAL REQUIREMENTS RELATING TO EMPLOYEE STOCK OWNERSHIP PLANS.—

"(A) IN GENERAL.—In the case of a trust which is part of an employee stock ownership plan (within the meaning of section 4975(e)(7)) or a plan which meets the requirements of section 409(a), such trust shall not constitute a qualified trust under this section unless such plan meets the requirements of subparagraphs (B) and (C).

"(B) DIVERSIFICATION OF INVESTMENTS.—

"(i) IN GENERAL.—A plan meets the requirements of this subparagraph if each qualified participant in the plan may elect within 90 days after the close of each plan year in the qualified election period to direct the plan as to the investment of at least 25 percent of the participant's account in the plan (to the extent such portion exceeds the amount to which a prior election under this subparagraph applies). In the case of the election year in which the participant can make his last election, the preceding sentence shall be applied by substituting '50 percent' for '25 percent'.

"(ii) METHOD OF MEETING REQUIREMENTS.—A plan shall be treated as meeting the requirements of clause (i) if—

"(I) the portion of the participant's account covered by the election under clause (i) is distributed within 90 days after the period during which the election may be made, or

"(II) the plan offers at least 3 investment options (not inconsistent with regulations prescribed by the Secretary) to each participant making an election under clause (i).

"(iii) QUALIFIED PARTICIPANT.—For purposes of this subparagraph, the term 'qualified participant' means any employee who has completed at least 10 years of participation under the plan and has attained age 55.

"(iv) Qualified election period.—For purposes of this subparagraph, the term 'qualified election period' means the 5-plan-year period beginning with the plan year after the plan year in which the participant attains age 55 (or, if later, beginning with the plan year after the 1st plan year in which the individual 1st became a qualified participant).

"(C) Use of independent appraiser.—A plan meets the requirements of this subparagraph if all valuations of employer securities which are not readily tradable on an established securities market with respect to activities carried on by the plan are by an independent appraiser. For purposes of the preceding sentence, the term 'independent appraiser' means any appraiser meeting requirements similar to the requirements of the regulations prescribed under section 170(a)(1)."

(2) Effective date.—The amendment made by this subsection shall apply to stock acquired after December 31, 1986.

SEC. 1176. SPECIAL ESOP REQUIREMENTS.

(a) In General.—Section 401(a)(22) (relating to qualified pension, profit sharing and stock bonus plans) is amended by inserting at the end thereof the following new sentence: "The requirements of subsection (e) of section 409 shall not apply to any employees of an employer who are participants in any defined contribution plan established and maintained by such employer if the stock of such employer is not publicly traded and the trade or business of such employer consists of publishing on a regular basis a newspaper for general circulation."

(b) Section 409(l) is amended by adding at the end thereof the following new paragraph:

"(4) Nonvoting common stock may be acquired in certain cases.—Nonvoting common stock of an employer described in the last sentence of section 401(a)(22) shall be treated as employer securities if an employer has a class of nonvoting common stock outstanding and the specific shares that the plan acquires have been issued and outstanding for at least 24 months."

(c) Effective Dates.—The amendment made by subsection (a) shall be effective December 31, 1986. The amendment made by subsection (b) shall apply to acquisitions of securities after December 31, 1986.

SEC. 1177. TRANSITION RULES.

(a) Section 1171.—The amendments made by section 1171 shall not apply in the case of a tax credit employee stock ownership plan if—

(1) such plan was favorably approved on September 23, 1983, by employees, and

(2) not later than January 11, 1984, the employer of such employees was 100 percent owned by such plan.

(b) Subtitle Not To Apply to Certain Newspaper.—The amendments made by this subtitle shall not apply to any daily newspaper—

(1) which was first published on December 17, 1855, and which began publication under its current name in 1954, and

(2) which is published in a constitutional home rule city (within the meaning of section 143(d)(3)(C) of the Internal Revenue Code of 1986) which has a population of less than 2,500,000.

TITLE XII—FOREIGN TAX PROVISIONS

Subtitle A—Foreign Tax Credit Modifications

SEC. 1201. SEPARATE APPLICATION OF SECTION 904 WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.

(a) GENERAL RULE.—Paragraph (1) of section 904(d) (relating to separate application of section 904 with respect to certain income) is amended by striking out subparagraph (A), by redesignating subparagraphs (B), (C), (D), and (E) as subparagraphs (F), (G), (H), and (I), respectively, and by inserting before subparagraph (F) (as so redesignated) the following new subparagraphs:

"(A) passive income,

"(B) high withholding tax interest,

"(C) financial services income,

"(D) shipping income,

"(E) dividends from each noncontrolled section 902 corporation,".

(b) CATEGORIES DEFINED.—Subsection (d) of section 904 is amended by striking out paragraphs (2) and (3) and inserting in lieu thereof the following new paragraphs:

"(2) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) PASSIVE INCOME.—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term 'passive income' means any income received or accrued by any person which is of a kind which would be foreign personal holding company income (as defined in section 954(c)).

"(ii) CERTAIN AMOUNTS INCLUDED.—The term 'passive income' includes any amount includible in gross income under section 551 or section 1293 (relating to certain passive foreign investment companies).

"(iii) EXCEPTIONS.—The term 'passive income' shall not include—

"(I) any income described in a subparagraph of paragraph (1) other than subparagraph (A),

"(II) any export financing interest,

"(III) any high-taxed income, and

"(IV) any foreign oil and gas extraction income (as defined in section 907(c)).

"(B) HIGH WITHHOLDING TAX INTEREST.—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term 'high withholding tax interest' means any interest if—

"(I) such interest is subject to a withholding tax of a foreign country or possession of the United

States (or other tax determined on a gross basis), and

"(II) the rate of such tax applicable to such interest is at least 5 percent.

"(ii) EXCEPTION FOR EXPORT FINANCING.—The term 'high withholding tax interest' shall not include any export financing interest.

"(iii) REGULATIONS.—The Secretary may by regulations provide that amounts (not otherwise high withholding tax interest) shall be treated as high withholding tax interest where necessary to prevent avoidance of the purposes of this subparagraph.

"(C) FINANCIAL SERVICES INCOME.—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the term 'financial services income' means income received or accrued by any person which is not passive income (determined without regard to subparagraph (A)(iii)(I) and which—

"(I) is derived in the active conduct of a banking, financing, or similar business, or derived from the investment by an insurance company of its unearned premiums or reserves ordinary and necessary for the proper conduct of its insurance business,

"(II) is of a kind which would be insurance income as defined in section 953(a) determined without regard to those provisions of paragraphs (1)(A) of such section which limit insurance income to income from countries other than the country in which the corporation was created or organized.

"(ii) SPECIAL RULE IF ENTITY PREDOMINANTLY ENGAGED IN BANKING, ETC., BUSINESS.—If, for any taxable year, an entity is predominantly engaged in the active conduct of a banking, insurance, financing, or similar business, the term 'financial services income' includes any passive income (determined without regard to subparagraph (A)(iii)(I)) of such corporation for such taxable year. In the case of any entity described in the preceding sentence, the term 'shipping income' shall not include any income treated as financial services income under the preceding sentence.

"(iii) EXCEPTION FOR EXPORT FINANCING.—The term 'financial services income' does not include any export financing interest.

"(iv) HIGH WITHHOLDING TAX INTEREST.—The term 'financial services income' does not include any high withholding tax interest.

"(D) SHIPPING INCOME.—The term 'shipping income' means any income received or accrued by any person which is of a kind which would be foreign base company shipping income (as defined in section 954(f)).

"(E) NONCONTROLLED SECTION 902 CORPORATION.—

"(i) IN GENERAL.—The term 'noncontrolled section 902 corporation' means any foreign corporation with re-

spect to which the taxpayer meets the stock ownership requirements of section 902(a) (or, for purposes of applying paragraph (3), the requirements of section 902(b)). A controlled foreign corporation shall not be treated as a noncontrolled section 902 corporation with respect to any distribution out of its earnings and profits for periods during which it was a controlled foreign corporation.

"(ii) SPECIAL RULE FOR TAXES ON HIGH-WITHHOLDING TAX INTEREST.—If a foreign corporation is a noncontrolled section 902 corporation with respect to the taxpayer, taxes on high withholding tax interest (to the extent imposed at a rate in excess of 5 percent) shall not be treated as foreign taxes for purposes of determining the amount of foreign taxes deemed paid by the taxpayer under section 902.

"(F) HIGH-TAXED INCOME.—The term 'high-taxed income' means any income which (but for this subparagraph) would be passive income if the sum of—

"(i) the foreign income taxes paid or accrued by the taxpayer with respect to such income, and

"(ii) the foreign income taxes deemed paid by the taxpayer with respect to such income under section 902 or 960,

exceeds the highest rate of tax specified in section 1 or 11 (whichever applies) multiplied by the amount of such income (determined with regard to section 78). For purposes of the preceding sentence, the term 'foreign income taxes' means any income, war profits, or excess profits tax imposed by any foreign country or possession of the United States.

"(G) EXPORT FINANCING INTEREST.—For purposes of this paragraph, the term 'export financing interest' means any interest derived from financing the sale (or other disposition) for use or consumption outside the United States of any property—

"(i) which is manufactured, produced, grown, or extracted in the United States by the taxpayer or a related person, and

"(ii) not more than 50 percent of the fair market value of which is attributable to products imported into the United States.

For purposes of clause (ii), the fair market value of any property imported into the United States shall be its appraised value, as determined by the Secretary under section 402 of the Tariff Act of 1930 (19 U.S.C. 1401a) in connection with its importation.

"(H) RELATED PERSON.—For purposes of this paragraph, the term 'related person' has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting 'the person with respect to whom the determination is being made' for 'controlled foreign corporation' each place it appears.

"(I) TRANSITIONAL RULE.—For purposes of paragraph (1)—

"(i) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income which was described in subparagraph (A) of paragraph (1) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) shall be treated as taxes paid or accrued with respect to income described in subparagraph (A) of paragraph (1) (as in effect after such date),

"(ii) taxes paid or accrued in a taxable year beginning before January 1, 1986, with respect to income which was described in subparagraph (E) of paragraph (1) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) shall be treated as taxes paid or accrued with respect to income described in subparagraph (I) of paragraph (1) (as in effect after such date) except to the extent that—

"(I) the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to shipping income, or

(II) in the case of an entity meeting the requirements of subparagraph (C)(ii), the taxpayer establishes to the satisfaction of the Secretary that such taxes were paid or accrued with respect to financial services income, and

"(iii) taxes paid or accrued in a taxable year beginning before January 1, 1987, with respect to income described in any other subparagraph of paragraph (1) (as so in effect before such date) shall be treated as taxes paid or accrued with respect to income described in the corresponding subparagraph of paragraph (1) (as so in effect after such date).

"(3) LOOK-THRU IN CASE OF CONTROLLED FOREIGN CORPORATIONS.—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, dividends, interest, rents, and royalties received or accrued by the taxpayer from a controlled foreign corporation in which the taxpayer is a United States shareholder shall not be treated as income in a separate category.

"(B) SUBPART F INCLUSIONS.—Any amount included in gross income under section 951(a)(1)(A) shall be treated as income in a separate category to the extent the amount so included is attributable to income in such category.

"(C) INTEREST, RENTS, AND ROYALTIES.—Any interest, rent, or royalty which is received or accrued from a controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated as income in a separate category to the extent it is properly allocable (under regulations prescribed by the Secretary) to income of the controlled foreign corporation in such category.

"(D) DIVIDENDS.—Any dividend paid out of the earnings and profits of any controlled foreign corporation in which the taxpayer is a United States shareholder shall be treated

as income in a separate category in proportion to the ratio of—

"(i) the portion of the earnings and profits attributable to income in such category, to

"(ii) the total amount of earnings and profits.

"(E) LOOK-THRU APPLIES ONLY WHERE SUBPART F APPLIES.—If a controlled foreign corporation meets the requirements of section 954(b)(3)(A) (relating to de minimis rule) for any taxable year, for purposes of this paragraph, none of its income for such taxable year shall be treated as income in a separate category. Solely for purposes of applying subparagraph (D), income (other than high withholding tax interest and dividends from a noncontrolled section 902 corporation) of a controlled foreign corporation shall not be treated as income in a separate category if the requirements of section 954(b)(4) are met with respect to such income.

"(F) SEPARATE CATEGORY.—For purposes of this paragraph, the term 'separate category' means any category of income described in subparagraph (A), (B), (C), (D), or (E) of paragraph (1).

"(G) DIVIDEND.—For purposes of this paragraph, the term 'dividend' includes any amount included in gross income in section 951(a)(1)(B). Any amount included in gross income under section 78 to the extent attributable to amounts included in gross income in section 951(a)(1)(A) shall not be treated as a dividend but shall be treated as included in gross income under section 951(a)(1)(A).

"(4) CONTROLLED FOREIGN CORPORATION; UNITED STATES SHAREHOLDER.—For purposes of this subsection—

"(A) CONTROLLED FOREIGN CORPORATION.—The term 'controlled foreign corporation' has the meaning given such term by section 957 (taking into account section 953(c)).

"(B) UNITED STATES SHAREHOLDER.—The term 'United States shareholder' has the meaning given such term by section 951(b) (taking into account section 953(c)).

"(5) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate for the purposes of this subsection, including regulations—

"(A) for the application of paragraph (3) and subsection (f)(5) in the case of income paid (or loans made) through 1 or more entities or between 2 or more chains of entities,

"(B) preventing the manipulation of the character of income the effect of which is to avoid the purposes of this subsection, and

"(C) providing that rules similar to the rules of paragraph (3)(C) shall apply to interest, rents, and royalties received or accrued from entities which would be controlled foreign corporations if they were foreign corporations."

(c) SOURCE RULE.—Paragraph (5) of section 954(b) (relating to deductions) is amended by adding at the end thereof the following new sentence: "Except to the extent provided in regulations prescribed by the Secretary, any interest which is paid or accrued by the controlled foreign corporation to any United States shareholder in such corporation (or any controlled foreign corporation related to

such a shareholder) shall be allocated first to foreign personal holding company income which is passive income (within the meaning of section 904(1)(2)) of such corporation to the extent thereof. The Secretary may, by regulations, provide that the preceding sentence shall apply also to interest paid or accrued to other persons."

(d) TECHNICAL AMENDMENTS.—

(1) The subsection heading of section 904(d) is amended to read as follows:

"(d) SEPARATE APPLICATION OF SECTION WITH RESPECT TO CERTAIN CATEGORIES OF INCOME.—".

(2) Subparagraph (I) of section 904(d)(1) (as redesignated by subsection (a)) is amended by striking out "in subparagraph (A), (B), (C), or (D)" and inserting in lieu thereof "in any of the preceding subparagraphs".

(3) Paragraph (1) of section 904(d) is amended by inserting "and sections 902, 907, and 960" after "subsections (a), (b), and (c)".

(4) Clause (i) of section 864(d)(5)(A) is amended to read as follows:

"(i) Subparagraphs (A)(iii)(II), (B)(ii), and (C)(iii) of section 904(d)(2) (relating to exceptions for export financing interest)."

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) QUALIFIED LOANS.—

(A) IN GENERAL.—The following shall not be treated as high withholding tax interest for purposes of applying section 904(d) of the Internal Revenue Code of 1986 (as amended by this section):

(i) Any interest received or accrued by any taxpayer during any taxable year beginning after December 31, 1986, and before January 1, 1990, on any pre-1990 qualified loan, and

(ii) The phase-out percentage of any interest received or accrued by any taxpayer during any taxable year beginning after December 31, 1989 on any post-1989 qualified loan.

(B) PHASE-OUT PERCENTAGE.—For purposes of subparagraph (A) the phase-out percentage is—

In the case of the following taxable years beginning after 12/31/89:	The phase out percentage is:
1st	80
2nd	60
3rd	40
4th	20
5th or succeeding	0

(C) PRE-1990 QUALIFIED LOAN.—For purposes of subparagraph (A), the term "pre-1990 qualified loan" means, with respect to any taxable year beginning before January 1, 1990, any qualified loan outstanding at any time during such taxable year to the extent that the total amount of for-

eign taxes which would be creditable (without regard to the limitation of section 904 of the Internal Revenue Code of 1986) with respect to all qualified loans outstanding at any time during such taxable year does not exceed the applicable credit limit for such taxable year.

(D) Post-1989 qualified loans.—For purposes of subparagraph (A), the term "post-1989 qualified loan" means any qualified loan outstanding as of the close of the 1st taxable year of the taxpayer beginning after December 31, 1988, to the extent that the total amount of foreign taxes which would be creditable (without regard to the limitation of section 904 of the Internal Revenue Code of 1986) with respect to all qualified loans outstanding as of the close of such taxable year does not exceed the applicable credit limit for post-1989 qualified loans.

(E) Classification of qualified loans.—For purposes of this paragraph, if the foreign taxes creditable for any taxable year beginning before January 1, 1990, with respect to any qualified loan, when added to the aggregate amount of foreign taxes creditable for such taxable year with respect to qualified loans entered into by the taxpayer before the date on which such qualified loan was entered into, exceed the applicable credit limit, then that portion of a qualified loan which causes the taxpayer to exceed the applicable credit limit shall not be treated as a pre-1990 or post-1989 qualified loan, as the case may be.

(F) Applicable credit limit.—

(i) In general.—The applicable credit limit shall be equal to—

(I) except as provided in subclause (II), 110 percent of the base credit amount multiplied by the applicable interest rate adjustment for the taxable year, and

(II) in the case of post-1989 qualified loans, the amount determined under subclause (I) (without regard to the interest rate adjustment) multiplied by the interest rate adjustment for post-1989 qualified loans.

(ii) Base credit amount.—The base credit amount of a taxpayer shall be an amount equal to the principal amount of qualified loans held by such taxpayer on November 16, 1985, multiplied by the product of—

(I) the interest rate applicable to such loan on November 16, 1985, and

(II) the foreign withholding tax rate applicable to interest payable with respect to such loan on November 16, 1985.

(G) Interest rate adjustment.—

(i) In general.—Except as provided in clause (ii), the applicable interest rate adjustment shall equal the ratio of the weighted average 6-month London Interbank Offered Rate (LIBOR) for the taxable year in question to LIBOR on November 15, 1985.

(ii) Post-1989 qualified loans.—The applicable interest rate adjustment for post-1989 qualified loans shall be equal to the ratio of LIBOR on the last day of the taxpayer's 1st taxable year beginning after December 31, 1988 to LIBOR on November 15, 1985.

(H) Qualified loan.—For purposes of this subsection, the term "qualified loan" means any loan made by the taxpayer to any of the following countries or any resident thereof for use in such country:

(i) Argentina.
(ii) Bolivia.
(iii) Brazil.
(iv) Chile.
(v) Colombia.
(vi) Costa Rica.
(vii) The Dominican Republic.
(viii) Ecuador.
(ix) Guyana.
(x) Honduras.
(xi) The Ivory Coast.
(xii) Jamaica.
(xiii) Liberia.
(xiv) Madagascar.
(xv) Malawi.
(xvi) Mexico.
(xvii) Morocco.
(xviii) Mozambique.
(xix) Niger.
(xx) Nigeria.
(xxi) Panama.
(xxii) Peru.
(xxiii) The Philippines.
(xxiv) Romania.
(xxv) Senegal.
(xxvi) Sierra Leone.
(xxvii) The Sudan.
(xviii) Togo.
(xxix) Uruguay.
(xxx) Venezuela.
(xxxi) Yugoslavia.
(xxxii) Zaire.
(xxxiii) Zambia.

(I) No benefit for increased withholding taxes.—No benefit shall be allowable by reason of this paragraph for any foreign withholding tax imposed on interest payable with respect to any qualified loan to the extent the rate of such tax exceeds the foreign withholding tax rate applicable to interest payable with respect to such loan on November 16, 1985.

(3) Special rule for taxpayer with overall foreign loss.—

(A) In general.—If a taxpayer incorporated on June 20, 1928, the principal headquarters of which is in Minneapolis, Minnesota, sustained an overall foreign loss (as defined in section 904(f)(2) of the Internal Revenue Code of 1954) in taxable years beginning before January 1, 1986, in connection with 2 separate trades or businesses which the taxpayer had, during 1985, substantially disposed of in tax-free transactions pursuant to section 355 of such Code, then an amount, not to exceed $40,000,000 of foreign source income, which, but for this paragraph, would not be treated as overall limitation income, shall be so treated.

(B) Substantial disposition.—For purposes of this paragraph, a taxpayer shall be treated as having substantially disposed of a trade or business if the retained portion of such business had sales of less than 10 percent of the

annual sales of such business for taxable years ending in 1985.

SEC. 1202. DEEMED PAID CREDIT UNDER SECTIONS 902 AND 960 DETERMINED ON ACCUMULATED BASIS.

(a) GENERAL RULE.—Section 902 (relating to credit for corporate stockholder in foreign corporation) is amended to read as follows:

"SEC. 902. DEEMED PAID CREDIT WHERE DOMESTIC CORPORATION OWNS 10 PERCENT OR MORE OF VOTING STOCK OF FOREIGN CORPORATION.

"(a) TAXES PAID BY FOREIGN CORPORATION TREATED AS PAID BY DOMESTIC CORPORATION.—For purposes of this subpart, a domestic corporation which owns 10 percent or more of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of such foreign corporation's post-1986 foreign income taxes as—

"(1) the amount of such dividends (determined without regard to section 78), bears to

"(2) such foreign corporation's post-1986 undistributed earnings.

"(b) DEEMED TAXES INCREASED IN CASE OF CERTAIN 2ND AND 3RD TIER FOREIGN CORPORATIONS.—

"(1) 2ND TIER.—If the foreign corporation described in subsection (a) (hereinafter in this section referred to as the '1st tier corporation') owns 10 percent or more of the voting stock of a 2nd foreign corporation from which it receives dividends in any taxable year, the 1st tier corporation shall be deemed to have paid the same proportion of such 2nd foreign corporation's post-1986 foreign income taxes as would be determined under subsection (a) if such 1st tier corporation were a domestic corporation.

"(2) 3RD TIER.—If such 1st tier corporation owns 10 percent or more of the voting stock of a 2nd foreign corporation which, in turn, owns 10 percent or more of the voting stock of a 3rd foreign corporation from which the 2nd corporation receives dividends in any taxable year, such 2nd foreign corporation shall be deemed to have paid the same proportion of such 3rd foreign corporation's post-1986 foreign income taxes as would be determined under subsection (a) if such 2nd foreign corporation were a domestic corporation.

"(3) 5 PERCENT STOCK REQUIREMENT.—For purposes of this subpart—

"(A) FOR 2ND TIER.—Paragraph (1) shall not apply unless the percentage of voting stock owned by the domestic corporation in the 1st tier corporation and the percentage of voting stock owned by the 1st tier corporation in the 2nd foreign corporation when multiplied together equal at least 5 percent.

"(B) FOR 3RD TIER.—Paragraph (2) shall not apply unless the percentage arrived at for purposes of applying paragraph (1) when multiplied by the percentage of voting stock owned by the 2nd foreign corporation in the 3rd foreign corporation is equal to at least 5 percent.

"(c) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) POST-1986 UNDISTRIBUTED EARNINGS.—The term 'post-1986 undistributed earnings' means the amount of the earnings and profits of the foreign corporation (computed in accordance with sections 964 and 986) accumulated in taxable years beginning after December 31, 1986—

"(A) as of the close of the taxable year of the foreign corporation in which the dividend is distributed, and

"(B) without diminution by reason of dividends distributed during such taxable year.

"(2) POST-1986 FOREIGN INCOME TAXES.—The term 'post-1986 foreign income taxes' means the sum of—

"(A) the foreign income taxes with respect to the taxable year of the foreign corporation in which the dividend is distributed, and

"(B) the foreign income taxes with respect to prior taxable years beginning after December 31, 1986, to the extent such foreign taxes were not deemed paid with respect to dividends distributed by the foreign corporation in prior taxable years.

"(3) SPECIAL RULE WHERE DOMESTIC CORPORATION ACQUIRES 10 PERCENT OF FOREIGN CORPORATION AFTER DECEMBER 31, 1986.—

"(A) IN GENERAL.—If the 1st day on which the ownership requirements of subparagraph (B) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 foreign income taxes of such foreign corporation shall be determined by taking into account only periods beginning on and after the 1st day of the 1st taxable year in which such ownership requirements are met.

"(B) OWNERSHIP REQUIREMENTS.—The ownership requirements of this subparagraph are met with respect to any foreign corporation if—

"(i) 10 percent or more of the voting stock of such foreign corporation is owned by a domestic corporation,

"(ii) the requirements of subsection (b)(3)(A) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (i), or

"(iii) the requirements of subsection (b)(3)(B) are met with respect to such foreign corporation and 10 percent or more of the voting stock of such foreign corporation is owned by another foreign corporation described in clause (ii).

"(4) FOREIGN INCOME TAXES.—

"(A) IN GENERAL.—The term 'foreign income taxes' means any income, war profits, or excess profits taxes paid by the foreign corporation to any foreign country or possession of the United States.

"(B) TREATMENT OF DEEMED TAXES.—Except for purposes of determining the amount of the post-1986 foreign income taxes of a 3rd foreign corporation referred to in subsection

(b)(2), the term 'foreign income taxes' includes any such taxes deemed to be paid by the foreign corporation under this section.

"(5) Accounting periods.—In the case of a foreign corporation the income, war profits, and excess profits taxes of which are determined on the basis of an accounting period of less than 1 year, the word 'year' as used in this subsection shall be construed to mean such accounting period.

"(6) Treatment of distributions from earnings before 1987.—

"(A) In general.—In the case of any dividend paid by a foreign corporation out of accumulated profits (as defined in this section as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) for taxable years beginning before the 1st taxable year taken into account in determining the post-1986 undistributed earnings of such corporation—

"(i) this section (as amended by the Tax Reform Act of 1986) shall not apply, but

"(ii) this section (as in effect on the day before the date of the enactment of such Act) shall apply.

"(B) Dividends paid first out of post-1986 earnings.—Any dividend in a taxable year beginning after December 31, 1986, shall be treated as made out of post-1986 undistributed earnings to the extent thereof.

"(7) Regulations.—The Secretary shall provide such regulations as may be necessary or appropriate to carry out the provisions of this section and secton 960, including provisions which provide for the separate application of this section to reflect the separate application of section 904 to separate types of income and loss.

"(d) Cross References.—

"(1) For inclusion in gross income of an amount equal to taxes deemed paid under subsection (a), see section 78.

"(2) For application of subsections (a) and (b) with respect to taxes deemed paid in a prior taxable year by a United States shareholder with respect to a controlled foreign corporation, see section 960.

"(3) For reduction of credit with respect to dividends paid out of post-1986 undistributed earnings for years for which certain information is not furnished, see section 6038."

(b) Section 960 Credit Determined on Accumulated Basis.—The first sentence of section 960(a)(1) (relating to taxes paid by a foreign corporation) is amended by striking out "then" and all that follows down through the period at the end thereof and inserting in lieu thereof the following:

"then, except to the extent provided in regulations, such domestic corporation shall be deemed to have paid a portion of such foreign corporation's post-1986 foreign income taxes determined under section 902 in the same manner as if the amount so included were a dividend paid by such foreign corporation (determined by applying section 902(c) in accordance with section 904(d)(3)(B))."

(c) Technical Amendments.—

(1) Subparagraph (B) of section 6038(a)(1) (relating to information with respect to certain foreign corporations) is amended to read as follows:

"(B) the post-1986 undistributed earnings (as defined in section 902(c)) of such foreign corporation,".

(2) Subparagraph (C) of section 6038(c)(4) (relating to penalty of reducing foreign tax credit) is amended by striking out all that follows "the amount of" and inserting in lieu thereof "post-1986 undistributed earnings."

(d) CLERICAL AMENDMENT.—The table of sections for subpart A of part III of subchapter N of chapter 1 is amended by striking out the item relating to section 902 and inserting in lieu thereof the following:

"Sec. 902. Deemed paid credit where domestic corporation owns 10 percent or more of voting stock of foreign corporation."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions by foreign corporations out of, and to inclusions under section 951(a) of the Internal Revenue Code of 1986 attributable to, earnings and profits for taxable years beginning after December 31, 1986.

SEC. 1203. CLARIFICATION OF TREATMENT OF SEPARATE LIMITATION LOSSES.

(a) GENERAL RULE.—Subsection (f) of section 904 (relating to recapture of overall foreign loss) is amended by adding at the end thereof the following new paragraph:

"(5) TREATMENT OF SEPARATE LIMITATION LOSSES.—

"(A) IN GENERAL.—The amount of the separate limitation losses for any taxable year shall reduce income from sources within the United States for such taxable year only to the extent the aggregate amount of such losses exceeds the aggregate amount of the separate limitation incomes for such taxable year.

"(B) ALLOCATION OF LOSSES.—The separate limitation losses for any taxable year (to the extent such losses do not exceed the separate limitation incomes for such year) shall be allocated among (and operate to reduce) such incomes on a proportionate basis.

"(C) RECHARACTERIZATION OF SUBSEQUENT INCOME.—If—

"(i) a separate limitation loss from any income category (hereinafter in this subparagraph referred to as 'the loss category') was allocated to income from any other category under subparagraph (B), and

"(ii) the loss category has income for a subsequent taxable year,

such income (to the extent it does not exceed the aggregate separate limitation losses from the loss category not previously recharacterized under this subparagraph) shall be recharacterized as income from such other category in proportion to the prior reductions under subparagraph (B) in such other category not previously taken into account under this subparagraph. Nothing in the preceding sentence shall be construed as recharacterizing any tax.

"(D) Special rules for losses from sources in the United States.—Any loss from sources in the United States for any taxable year (to the extent such loss does not exceed the separate limitation incomes from such year) shall be allocated among (and operate to reduce) such incomes on a proportionate basis. This subparagraph shall be applied after subparagraph (B).

"(E) Definitions.—For purposes of this paragraph—

"(i) Income category.—The term 'income category' means each separate category of income described in subsection (d)(1).

"(ii) Separate limitation income.—The term 'separate limitation income' means, with respect to any income category, the taxable income from sources outside the United States, separately computed for such category.

"(iii) Separate limitation loss.—The term 'separate limitation loss' means, with respect to any income category, the loss from such category determined under the principles of section 907(c)(4)(B)."

(b) Effective Date.—The amendment made by subsection (a) shall apply to losses incurred in taxable years beginning after December 31, 1986.

SEC. 1204. FOREIGN TAXES USED TO PROVIDE SUBSIDIES.

(a) Treatment of Certain Subsidies.—Section 901 (relating to credit for foreign taxes) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) Taxes Used To Provide Subsidies.—Any income, war profits, or excess profits tax shall not be treated as a tax for purposes of this title to the extent—

"(1) the amount of such tax is used (directly or indirectly) by the country imposing such tax to provide a subsidy by any means to the taxpayer, a related person (within the meaning of section 482), or any party to the transaction or to a related transaction, and

"(2) such subsidy is determined (directly or indirectly) by reference to the amount of such tax, or the base used to compute the amount of such tax."

(b) Effective Date.—The amendment made by subsection (a) shall apply to foreign taxes paid or accrued in taxable years beginning after December 31, 1986.

SEC. 1205. LIMITATION ON CARRYBACK OF FOREIGN TAX CREDITS TO TAXABLE YEARS BEGINNING BEFORE 1987.

(a) Determination of Excess Credits.—

(1) In general.—Any taxes paid or accrued in a taxable year beginning after 1986 may be treated under section 904(c) of the Internal Revenue Code of 1954 as paid or accrued in a taxable year beginning before 1987 only to the extent such taxes would be so treated if the tax imposed by chapter 1 of such Code for the taxable year beginning after 1986 were determined by applying section 1 or 11 of such Code (as the case may be) as in effect on the day before the date of the enactment of this Act.

(2) Adjustments.—Under regulations prescribed by the Secretary of the Treasury or his delegate proper adjustments shall be made in the application of paragraph (1) to take into account—

(A) the repeal of the zero bracket amount, and

(B) the changes in the treatment of capital gains.

(b) Coordination With Separate Baskets.—Any taxes paid or accrued in a taxable year beginning after 1986 which (after the application of subsection (a)) are treated as paid or accrued in a taxable year beginning before 1987 shall be treated as imposed on income described in section 904(d)(1)(E) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act). No taxes paid or accrued in a taxable year beginning after 1986 with respect to high withholding tax interest (as defined in section 904(d)(2)(B) of the Internal Revenue Code of 1986 as amended by this Act) may be treated as paid or accrued in a taxable year beginning before 1987.

Subtitle B—Source Rules

SEC. 1211. DETERMINATION OF SOURCE IN CASE OF SALES OF PERSONAL PROPERTY.

(a) Personal Property Source Rules.—Part I of subchapter N of chapter 1 (relating to determination of source of income) is amended by adding at the end thereof the following new section:

"SEC. 865. SOURCE RULES FOR PERSONAL PROPERTY SALES.

"(a) General Rule.—Except as otherwise provided in this section, income from the sale of personal property—

"(1) by a United States resident shall be sourced in the United States, or

"(2) by a nonresident shall be sourced outside the United States.

"(b) Exception for Inventory Property.—In the case of income derived from the sale of inventory property—

"(1) this section shall not apply, and

"(2) such income shall be sourced under the rules of sections 861(a)(6), 862(a)(6), and 863(b).

"(c) Exception for Depreciable Personal Property.—

"(1) In general.—Gain (not in excess of the depreciation adjustments) from the sale of depreciable personal property shall be allocated between sources in the United States and sources outside the United States—

"(A) by treating the same proportion of such gain as sourced in the United States as the United States depreciation adjustments with respect to such property bear to the total depreciation adjustments, and

"(B) by treating the remaining portion of such gain as sourced outside the United States.

"(2) Gain in excess of depreciation.—Gain (in excess of the depreciation adjustments) from the sale of depreciable personal property shall be sourced as if such property were inventory property.

"(3) United states depreciation adjustments.—For purposes of this subsection—

"(A) In general.—The term 'United States depreciation adjustments' means the portion of the depreciation adjustments to the adjusted basis of the property which are attributable to the depreciation deductions allowable in computing taxable income from sources in the United States.

"(B) Special rule for certain property.—Except in the case of property of a kind described in section 48(a)(2)(B), if, for any taxable year—

"(i) such property is used predominantly in the United States, or

"(ii) such property is used predominantly outside the United States,

all of the depreciation deductions allowable for such year shall be treated as having been allocated to income from sources in the United States (or, where clause (ii) applies, from sources outside the United States).

"(4) Other definitions.—For purposes of this subsection—

"(A) Depreciable personal property.—The term 'depreciable personal property' means any personal property if the adjusted basis of such property includes depreciation adjustments.

"(B) Depreciation adjustments.—The term 'depreciation adjustments' means adjustments reflected in the adjusted basis of any property on account of depreciation deductions (whether allowed with respect to such property or other property and whether allowed to the taxpayer or to any other person).

"(C) Depreciation deductions.—The term 'depreciation deductions' means any deductions for depreciation or amortization or any other deduction allowable under any provision of this chapter which treats an otherwise capital expenditure as a deductible expense.

"(d) Exception for Intangibles.—

"(1) In general.—In the case of any sale of an intangible—

"(A) this section shall apply only to the extent the payments in consideration of such sale are not contingent on the productivity, use, or disposition of the intangible, and

"(B) to the extent such payments are so contingent, the source of such payments shall be determined under this part in the same manner as if such payments were royalties.

"(2) Intangible.—For purposes of paragraph (1), the term 'intangible' means any patent, copyright, secret process or formula, goodwill, trademark, trade brand, or other like property.

"(3) Special rule in the case of goodwill.—To the extent this section applies to the sale of goodwill, payments in consideration of such sale shall be treated as from sources in the country in which such goodwill was generated.

"(e) Special Rules for Sales Through Offices or Fixed Places of Business.—

"(1) Sales by residents.—

"(A) In general.—In the case of income not sourced under subsection (b), (c), (d), or (f), if a United States resident maintains an office or other fixed place of business *outside the United States, income from sales of personal property attributable to such office or other fixed place of business shall be sourced outside the United States.*

"(B) Tax must be imposed.—Subparagraph (A) shall not apply unless an income tax equal to at least 10 percent of the income from the sale is actually paid to a foreign country with respect to such income.

"(2) Sales by nonresidents.—

"(A) In general.—Notwithstanding any other provisions of this part, if a nonresident maintains an office or other fixed place of business in the United States, income from any sale of personal property (including inventory property) attributable to such office or other fixed place of business shall be sourced in the United States. The preceding sentence shall not apply for purposes of section 971 (defining export trade corporation).

"(B) Exception.—Subparagraph (A) shall not apply to—

"(i) any sale of inventory property which is sold for use, disposition, or consumption outside the United States if an office or other fixed place of business of the taxpayer outside the United States materially participated in the sale, or

"(ii) any amount included in gross income under section 951(a)(1)(A).

"(3) Sales attributable to an office or other fixed place of business.—The principles of section 864(c)(5) shall apply in determining whether a taxpayer has an office or other fixed place of business and whether a sale is attributable to such an office or other fixed place of business.

"(f) Stock of Affiliates.—If—

"(1) a United States resident sells stock in an affiliate which is a foreign corporation,

"(2) such affiliate is engaged in the active conduct of a trade or business, and

"(3) such sale occurs in the foreign country in which the affiliate derived more than 50 percent of its gross income for the 3-year period ending with the close of the affiliate's taxable year immediately preceding the year during which such sale occurred,

any gain from such sale shall be sourced outside the United States.

"(g) United States Resident; Nonresident.—For purposes of this section—

"(1) In general.—Except as otherwise provided in this subsection—

"(A) United states resident.—The term 'United States resident' means—

"(i) any individual who has a tax home (as defined in section 911(d)(3)) in the United States, and

"(ii) any corporation, partnership, trust, or estate which is a United States person (as defined in section 7701(a)(30)).

"(B) Nonresident.—The term 'nonresident' means any person other than a United States resident.

"(2) SPECIAL RULES FOR UNITED STATES CITIZENS AND RESIDENT ALIENS.—For purposes of this section, a United States citizen or resident alien shall not be treated as a nonresident with respect to any sale of personal property unless an income tax equal to at least 10 percent of the gain derived from such sale is actually paid to a foreign country with respect to that gain.

"(h) OTHER DEFINITIONS.—For purposes of this section—

"(1) INVENTORY PROPERTY.—The term 'inventory property' means personal property described in paragraph (1) of section 1221.

"(2) SALE INCLUDES EXCHANGE.—The term 'sale' includes an exchange or any other disposition.

"(3) TREATMENT OF POSSESSIONS.—Any possession of the United States shall be treated as a foreign country.

"(4) AFFILIATE.—The term 'affiliate' means a member of the same affiliated group (within the meaning of section 1504(a) without regard to section 1504(b)).

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purpose of this section, including regulations—

"(1) relating to the treatment of losses from sales of personal property, and

"(2) applying the rules of this section to income derived from trading in futures contracts, forward contracts, options contracts, and other instruments.

"(j) CROSS REFERENCES.—

"(1) For provisions relating to the characterization as dividends for source purposes of gains from the sale of stock in certain foreign corporations, see section 1248.

"(2) For sourcing of income from certain foreign currency transactions, see section 988."

(b) CONFORMING AMENDMENTS.—

(1) Each of the following provisions are amended by striking out "personal property" and inserting in lieu thereof "inventory property (within the meaning of section 865(h)(1))":

(A) Paragraphs (2) and (3) of section 863(b).

(B) Paragraph (6) of section 861(a).

(C) Paragraph (6) of section 862(a).

(2) Subparagraph (B) of section 864(c)(4) is amended by adding "or" at the end of clause (i), by striking out "; or" at the end of clause (ii) and inserting in lieu thereof a period, and by striking out clause (iii).

(3) Paragraph (3) of section 904(b) is amended by striking out subparagraphs (C) and (D) and redesignating subparagraphs (E) and (F) as subparagraphs (C) and (D), respectively.

(4) Subparagraph (D) of section 871(a)(1) is amended by striking out "or from payments which are treated as being so contingent under subsection (e),".

(5) Subsection (e) of section 871 is hereby repealed.

(6) Paragraph (4) of section 881(a) is amended by striking out "or from payments which are treated as being so contingent under section 871(e),".

(c) EFFECTIVE DATES.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Special rule for foreign persons.—In the case of any foreign person other than any controlled foreign corporations (within the meaning of section 957(a) of the Internal Revenue Code of 1954), the amendments made by this section shall apply to transactions entered into after March 18, 1986.

(d) Study.—The Secretary of the Treasury or his delegate shall conduct a study of the source rules for sales of inventory property. Not later than September 30, 1987, the Secretary of the Treasury or his delegate shall submit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a report of such study (together with such recommendations as he may deem advisable).

SEC. 1212. SPECIAL RULES FOR TRANSPORTATION INCOME.

(a) General Rule.—Paragraph (2) of section 863(c) (relating to special rule for certain transportation income) is amended to read as follows:

"(2) Other transportation having United States connection.—

"(A) In general.—50 percent of all transportation income attributable to transportation which—

"(i) is not described in paragraph (1), and

"(ii) begins or ends in the United States,

shall be treated as from sources in the United States.

"(B) Special rule for personal service income.—Subparagraph (A) shall not apply to any transportation income which is income derived from personal services performed by the taxpayer, unless such income is attributable to transportation which—

"(i) begins in the United States and ends in a possession of the United States, or

"(ii) begins in a possession of the United States and ends in the United States."

(b) 4 Percent Tax on Gross Transportation Income.—

(1) In general.—Part II of subchapter N of chapter 1 (relating to nonresident alien individuals and foreign corporations) is amended by redesignating subpart C as subpart D and by inserting after subpart B the following new subpart:

"Subpart C—Tax on Gross Transportation Income

"Sec. 887. Imposition of tax on gross transportation income of nonresident aliens and foreign corporations.

"SEC. 887. IMPOSITION OF TAX ON GROSS TRANSPORTATION INCOME OF NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.

"(a) Imposition of Tax.—In the case of any nonresident alien individual or foreign corporation, there is hereby imposed for each taxable year a tax equal to 4 percent of such individual's or corporation's United States source gross transportation income for such taxable year.

"(b) United States Source Gross Transportation Income.—

"(1) In general.—Except as provided in paragraph (2), the term 'United States source gross transportation income' means any gross income which is transportation income (as defined in section 863(c)(3)) to the extent such income is treated as from sources in the United States under section 863(c).

"(2) Exception for certain income effectively connected with business in the United States.—The term 'United States source gross transportation income' shall not include any income taxable under section 871(b) or 882.

"(3) Determination of effectively connected income.—For purposes of this chapter, transportation income of any taxpayer shall not be treated as effectively connected with the conduct of a trade or business in the United States unless—

"(A) the taxpayer has a fixed place of business in the United States involved in the earning of transportation income, and

"(B) substantially all of the United States source gross transportation income (determined without regard to paragraph (2)) of the taxpayer is attributable to regularly scheduled transportation (or, in the case of income from the leasing of a vessel or aircraft, is attributable to a fixed place of business in the United States).

"(c) Coordination With Other Provisions.—Any income taxable under this section shall not be taxable under section 871, 881, or 882."

(2) Clerical amendment.—The table of subparts for part II of subchapter N is amended by striking out the item relating to subpart C and inserting in lieu thereof the following:

"Subpart C. Tax on gross transportation income.
"Subpart D. Miscellaneous provisions."

(c) Limitation on Exclusion of Transportation Income.—

(1) Subsection (b) of section 872 (relating to exclusions) is amended by striking out paragraphs (1) and (2) and inserting in lieu thereof the following:

"(1) Ships operated by certain nonresidents.—Gross income derived by an individual resident of a foreign country from the operation of a ship or ships if such foreign country grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

"(2) Aircraft operated by certain nonresidents.—Gross income derived by an individual resident of a foreign country from the operation of aircraft if such foreign country grants an equivalent exemption to citizens of the United States and to corporations organized in the United States."

(2) Section 872(b) is amended by adding at the end thereof the following new paragraphs:

"(5) Certain rental income.—Income to which paragraphs (1) and (2) apply shall include income which is derived from the rental on a full or bareboat basis of a ship or ships or aircraft, as the case may be.

"(6) Application to different types of transportation.—The Secretary may provide that this subsection be applied sepa-

rately with respect to income from different types of transportation."

(3) Subsection (a) of section 883 (relating to exclusions from gross income) is amended by striking out paragraphs (1) and (2) and by inserting in lieu thereof the following:

"(1) SHIPS OPERATED BY CERTAIN FOREIGN CORPORATIONS.—Gross income derived by a corporation organized in a foreign country from the operation of a ship or ships if such foreign country grants an equivalent exemption to citizens of the United States and to corporations organized in the United States.

"(2) AIRCRAFT OPERATED BY CERTAIN FOREIGN CORPORATIONS.—Gross income derived by a corporation organized in a foreign country from the operation of aircraft if such foreign country grants an equivalent exemption to citizens of the United States and to corporations organized in the United States."

(4) Section 883(a) is amended by adding at the end thereof the following new paragraph:

"(4) SPECIAL RULES.—The rules of paragraphs (5) and (6) of section 872(b) shall apply for purposes of this subsection."

(5) Section 883 is amended by adding at the end thereof the following new subsection:

"(c) TREATMENT OF CERTAIN FOREIGN CORPORATIONS.—

"(1) IN GENERAL.—Paragraphs (1) and (2) of subsection (a) shall not apply to any foreign corporation if 50 percent or more of the value of the stock of such corporation is owned by individuals who are not residents of such foreign country or another foreign country meeting the requirements of such paragraphs (1) and (2).

"(2) TREATMENT OF CONTROLLED FOREIGN CORPORATIONS.—Paragraph (1) shall not apply to any foreign corporation which is a controlled foreign corporation (as defined in section 957(a)).

"(3) EXCEPTION FOR PUBLICLY TRADED CORPORATIONS.—Paragraph (1) shall not apply to any foreign corporation—

"(A) the stock of which is primarily and regularly traded on an established securities market in the foreign country in which such corporation is organized, or

"(B) which is wholly owned (either directly or indirectly) by another corporation meeting the requirements of subparagraph (A) and is organized in the same foreign country as such other corporation.

"(4) STOCK OWNERSHIP THROUGH ENTITIES.—For purposes of paragraph (1), stock owned (directly or indirectly) by or for a corporation, partnership, trust, or estate shall be treated as being owned proportionately by its shareholders, partners, or beneficiaries. Stock considered to be owned by a person by reason of the application of the preceding sentence shall, for purposes of applying such sentence, be treated as actually owned by such person."

(d) REPEAL OF SPECIAL TREATMENT FOR LEASED AIRCRAFT, ETC.—Section 861 is amended by striking out subsection (e) and by redesignating subsection (f) as subsection (e).

(e) Conforming Amendment.—Section 863(b)(1) is amended by striking out "transportation or other services" and inserting in lieu thereof "services".

(f) Effective Dates.—

(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Special rule for certain leased property.—The amendments made by subsections (a) and (d) shall not apply to any income attributable to property held by the taxpayer on January 1, 1986, if such property was first leased by the taxpayer before January 1, 1986, in a lease to which section 863(c)(2)(B) or 861(e) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act) applied.

(3) Special rule for certain ships leased by the United States Navy.—

(A) In general.—In the case of any property described in subparagraph (B), paragraph (2) shall be applied by substituting "1987" for "1986" each place it appears.

(B) Property to which paragraph applies.—Property described in this subparagraph consists of 4 ships which are to be leased by the United States Navy and which are the subject of Internal Revenue Service rulings issued on the following dates and which involved the following amount of financing, respectively:

March 5, 1986	*$176,844,000*
February 5, 1986	*64,567,000*
April 22, 1986	*64,598,000*
May 22, 1986	*175,300,000.*

SEC. 1213. SOURCE RULE FOR SPACE AND CERTAIN OCEAN ACTIVITIES.

(a) General Rule.—Section 863 (relating to items not specified in section 861 or 862) is amended by adding at the end thereof the following new subsections:

"(d) Source Rules for Space and Certain Ocean Activities.—

"(1) In general.—Except as provided in regulations, any income derived from a space or ocean activity—

"(A) if derived by a United States person, shall be sourced in the United States, and

"(B) if derived by a person other than a United States person, shall be sourced outside the United States.

"(2) Space or ocean activity.—For purposes of paragraph (1)—

"(A) In general.—The term 'space or ocean activity' means—

"(i) any activity conducted in space, and

"(ii) any activity conducted on or under water not within the jurisdiction (as recognized by the United States) of a foreign country, possession of the United States, or the United States.

Such term includes any activity conducted in Antarctica.

"(B) Exception for certain activities.—The term 'space or ocean activity' shall not include—

"(i) any activity giving rise to transportation income (as defined in section 863(c)),

"(ii) any activity giving rise to international communications income (as defined in subsection (e)(2)), and

"(iii) any activity with respect to mines, oil and gas wells, or other natural deposits to the extent within the United States or any foreign country or possession of the United States (as defined in section 638).

For purposes of applying section 638, the jurisdiction of any foreign country shall not include any jurisdiction not recognized by the United States.

"(e) INTERNATIONAL COMMUNICATIONS INCOME.—

"(1) SOURCE RULES.—

"(A) UNITED STATES PERSONS.—In the case of any United States person, 50 percent of any international communications income shall be sourced in the United States and 50 percent of such income shall be sourced outside the United States.

"(B) FOREIGN PERSONS.—

"(i) IN GENERAL.—Except as provided in regulations or clause (ii), in the case of any person other than a United States person, any international communications income shall be sourced outside the United States.

"(ii) SPECIAL RULE FOR INCOME ATTRIBUTABLE TO OFFICE OR FIXED PLACE OF BUSINESS IN THE UNITED STATES.—In the case of any person (other than a United States person) who maintains an office or other fixed place of business in the United States, any international communications income attributable to such office or other fixed place of business shall be sourced in the United States.

"(2) DEFINITION.—For purposes of this section, the term 'international communications income' includes all income derived from the transmission of communications or data from the United States to any foreign country or from any foreign country to the United States."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

SEC. 1214. LIMITATIONS ON SPECIAL TREATMENT OF 80-20 CORPORATIONS.

(a) INTEREST PAYMENTS.—

(1) IN GENERAL.—Subparagraph (B) of section 861(a)(1) (relating to interest) is amended to read as follows:

"(B) interest from a resident alien individual or domestic corporation, if such individual or corporation meets the 80-percent foreign business requirements of subsection (c)(1),".

(2) FOREIGN BUSINESS REQUIREMENTS.—Subsection (c) of section 861 is amended to read as follows:

"(c) FOREIGN BUSINESS REQUIREMENTS.—

"(1) FOREIGN BUSINESS REQUIREMENTS.—

"(A) IN GENERAL.—An individual or corporation meets the 80-percent foreign business requirements of this paragraph if it is shown to the satisfaction of the Secretary that

at least 80 percent of the gross income from all sources of such individual or corporation for the testing period is active foreign business income.

"(B) ACTIVE FOREIGN BUSINESS INCOME.—For purposes of subparagraph (A), the term 'active foreign business income' means gross income which—

"(i) is derived from sources outside the United States (as determined under this subchapter), and

"(ii) is attributable to the active conduct of a trade or business in a foreign country or possession of the United States by the individual or corporation (or by a subsidiary or chain of subsidiaries of such corporation).

"(C) TESTING PERIOD.—For purposes of this subsection, the term 'testing period' means the 3-year period ending with the close of the taxable year of the individual or corporation preceding the payment (or such part of such period as may be applicable). If the individual or corporation has no gross income for such 3-year period (or part thereof), the testing period shall be the taxable year in which the payment is made.

"(2) LOOK-THRU WHERE RELATED PERSON RECEIVES INTEREST.—

"(A) IN GENERAL.—In the case of interest received by a related person from a resident alien individual or domestic corporation meeting the 80-percent foreign business requirements of paragraph (1), subsection (a)(1)(A) shall apply only to a percentage of such interest equal to the percentage which—

"(i) the gross income of such individual or corporation for the testing period from sources outside the United States (as determined under this subchapter), is of

"(ii) the total gross income of such individual or corporation for the testing period.

"(B) RELATED PERSON.—For purposes of this paragraph, the term 'related person' has the meaning given such term by section 954(d)(3), except that—

"(i) such section shall be applied by substituting 'the individual or corporation making the payment' for 'controlled foreign corporation' each place it appears, and

"(ii) such section shall be applied by substituting '10 percent' for '50 percent' each place it appears."

(b) TREATMENT OF DIVIDENDS.—Subparagraph (A) of section 861(a)(2) (relating to dividends) is amended to read as follows:

"(A) from a domestic corporation other than a corporation which has an election in effect under section 936, or".

(c) WITHHOLDING TAX NOT TO APPLY TO CERTAIN INTEREST AND DIVIDENDS.—

(1) NONRESIDENT ALIENS.—Section 871 (relating to tax on nonresident aliens) is amended by redesignating subsection (i) as subsection (j) and by inserting after subsection (h) the following new subsection:

"(i) Tax Not To Apply to Certain Interest and Dividends.—

"(1) In general.—No tax shall be imposed under paragraph (1)(A) or (1)(C) of subsection (a) on any amount described in paragraph (2).

"(2) Amounts to which paragraph (1) applies.—The amounts described in this paragraph are as follows:

"(A) Interest on deposits, if such interest is not effectively connected with the conduct of a trade or business within the United States.

"(B) A percentage of any dividend paid by a domestic corporation meeting the 80-percent foreign business requirements of section 861(c)(1) equal to the percentage determined for purposes of section 861(c)(2)(A).

"(C) Income derived by a foreign central bank of issue from bankers' acceptances.

"(3) Deposits.—For purposes of paragraph (2), the term 'deposits' means amounts which are—

"(A) deposits with persons carrying on the banking business,

"(B) deposits or withdrawable accounts with savings institutions chartered and supervised as savings and loan or similar associations under Federal or State law, but only to the extent that amounts paid or credited on such deposits or accounts are deductible under section 591 (determined without regard to sections 265 and 291) in computing the taxable income of such institutions, and

"(C) amounts held by an insurance company under an agreement to pay interest thereon."

(2) Foreign corporations.—Section 881 (relating to tax on foreign corporations) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) Tax Not To Apply to Certain Interest and Dividends.—No tax shall be imposed under paragraph (1) or (3) of subsection (a) on any amount described in section 871(i)(2)."

(3) Withholding tax.—Subsection (c) of section 1441 (relating to exceptions) is amended by adding at the end thereof the following new paragraph:

"(10) Exception for certain interest and dividends.—No tax shall be required to be deducted and withheld under subsection (a) from any amount described in section 871(i)(2)."

(4) Reporting requirements.—Subparagraph (B) of section 6049(b)(5) is amended by striking out "or" at the end of clause (ii), by striking out the period at the end of clause (iii) and inserting in lieu thereof ", or", and by adding at the end thereof the following new clause:

"(iv) such amount is described in section 871(i)(2)."

(5) Conforming amendments.—

(A) Paragraph (1) of section 861(a) (as amended by subsection (a)) is amended by striking out subparagraphs (A) and (E) and by redesignating subparagraphs (B), (C), (D), (F), (G), and (H) as subparagraphs (A), (B), (C), (D), (E), and (F), respectively.

(B) Subparagraph (D) of section 861(a)(1) (as so redesignated) is amended by striking out "paragraph (2) of subsection (c)" and inserting in lieu thereof "subparagraph (B) of section 871(i)(3)".

(C) Subsection (d) of section 861 is amended to read as follows:

"(d) SPECIAL RULE FOR APPLICATION OF SUBSECTION (a)(2)(B).—For purposes of subsection (a)(2)(B), if the foreign corporation has no gross income from any source for the 3-year period (or part thereof) specified, the requirements of such subsection shall be applied with respect to the taxable year of such corporation in which the payment of the dividend is made."

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to payments after December 31, 1986.

(2) TREATMENT OF CERTAIN INTEREST.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any interest paid or accrued on any obligation outstanding on December 31, 1985. The preceding sentence shall not apply to any interest paid pursuant to any extension or renewal of such an obligation agreed to after December 31, 1985.

(B) SPECIAL RULE FOR RELATED PAYEE.—If the payee of any interest to which subparagraph (A) applies is related (within the meaning of section 904(d)(2)(G) of the Internal Revenue Code of 1986) to the payor, such interest shall be treated for purposes of section 904 of such Code as if the payor were a controlled foreign corporation (within the meaning of section 957(a) of such Code).

(3) TRANSITIONAL RULE.—

(A) YEARS BEFORE 1988.—In applying the amendments made by this section to any payment made by a corporation in a taxable year of such corporation beginning before January 1, 1988, the requirements of clause (ii) of section 861(c)(1)(B) of the Internal Revenue Code of 1986 (relating to active business requirements), as amended by this section, shall not apply to gross income of such corporation for taxable years beginning before January 1, 1987.

(B) YEARS AFTER 1987.—In applying the amendments made by this section to any payment made by a corporation in a taxable year of such corporation beginning after December 31, 1987, the testing period for purposes of section 861(c) of such Code (as so amended) shall not include any taxable year beginning before January 1, 1987.

(4) CERTAIN DIVIDENDS.—

(A) IN GENERAL.—The amendments made by this section shall not apply to any dividend paid before January 1, 1991, by a qualified corporation with respect to stock which was outstanding on May 31, 1985.

(B) QUALIFIED CORPORATION.—For purposes of subparagraph (A), the term 'qualified corporation' means any business systems corporation which—

(i) was incorporated in Delaware in February, 1979,

(ii) is headquartered in Garden City, New York, and

(iii) the parent corporation of which is a resident of Sweden.

SEC. 1215. RULES FOR ALLOCATING INTEREST, ETC., TO FOREIGN SOURCE INCOME.

(a) General Rule.—Section 864 (relating to definitions) is amended by adding at the end thereof the following new subsection:

"(e) Rules for Allocating Interest, Etc.—For purposes of this subchapter (except as provided in regulations)—

"(1) Treatment of affiliated groups.—The taxable income of each member of an affiliated group from sources outside the United States shall be determined by allocating and apportioning interest expense of each member as if all members of such group were a single corporation.

"(2) Gross income method may not be used for interest.—All allocations and apportionments of interest expense shall be made on the basis of assets rather than gross income.

"(3) Tax-exempt assets not taken into account.—For purposes of allocating and apportioning any deductible expense, any tax-exempt asset (and any income from such an asset) shall not be taken into account. A similar rule shall apply in the case of any dividend (other than a qualifying dividend as defined in section 243(b)) for which a deduction is allowable under section 243 or 245(a) and any stock the dividends on which would be so deductible and would not be qualifying dividends (as so defined).

"(4) Basis of stock in certain corporations adjusted for earnings and profits changes.—For purposes of allocating and apportioning expenses on the basis of assets, the adjusted basis of any asset which is stock in a corporation which is not included in the affiliated group and in which members of the affiliated group own 10 percent or more of the total combined voting power of all classes of stock entitled to vote in such corporation shall be—

"(A) increased by the amount of the earnings and profits of such corporation attributable to such stock and accumulated during the period the taxpayer held such stock, or

"(B) reduced (but not below zero) by any deficit in earnings and profits of such corporation attributable to such stock for such period.

"(5) Affiliated group.—For purposes of this subsection—

"(A) In general.—Except as provided in subparagraph (B), the term 'affiliated group' has the meaning given such term by section 1504 (determined without regard to paragraph (4) of section 1504(b)).

"(B) Treatment of certain financial institutions.—For purposes of subparagraph (A), any corporation described in subparagraph (C) shall be treated as an includible corporation for purposes of section 1504 only for purposes of applying such section separately to corporations so described.

"(C) Description.—A corporation is described in this subparagraph if—

"(i) such corporation is a financial institution described in section 581 or 591,

"(ii) the business of such financial institution is predominantly with persons other than related persons (within the meaning of subsection (d)(4)) or their customers, and

"(iii) such financial institution is required by State or Federal law to be operated separately from any other entity which is not such an institution.

"(6) ALLOCATION AND APPORTIONMENT OF OTHER EXPENSES.—Expenses other than interest which are not directly allocable and apportioned to any specific income producing activity shall be allocated and apportioned as if all members of the affiliated group were a single corporation.

"(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing—

"(A) for the resourcing of income of any member of an affiliated group or modifications to the consolidated return regulations to the extent such resourcing or modification is necessary to carry out the purposes of this section,

"(B) for direct allocation of interest expense incurred to carry out an integrated financial transaction to any interest (or interest-type income) derived from such transaction, and

"(C) for the apportionment of expenses allocated to foreign source income among the members of the affiliated group and various categories of income described in section 904(d)(1)."

(b) CLERICAL AMENDMENTS.—

(1) The section heading for section 864 is amended to read as follows:

"SEC. 864. DEFINITIONS AND SPECIAL RULES."

(2) The table of sections for part I of subchapter N of chapter 1 is amended by striking out the item relating to section 864 and inserting in lieu thereof the following:

"Sec. 864. Definitions and special rules."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) TRANSITIONAL RULES.—

(A) GENERAL PHASE-IN.—Except as provided in subparagraph (B), in the case of the 1st 3 taxable years of the taxpayer beginning after December 31, 1986, the amendments made by this section shall apply only to the applicable percentage (determined under the following table) of the interest expenses paid or accrued by the taxpayer during the taxable year with respect to an aggregate amount of indebtedness which does not exceed the aggregate amount of indebtedness outstanding on November 16, 1985:

In the case of the:	*The applicable percentage is:*
1st taxable year	*25*
2nd taxable year	*50*
3rd taxable year	*75.*

(B) CONSOLIDATION RULE NOT TO APPLY TO CERTAIN INTEREST.—

(i) INTEREST ATTRIBUTABLE TO INCREASE IN INDEBTEDNESS FROM JANUARY 1, 1984, THROUGH MAY 28, 1985.—In the case of the first 5 taxable years of the taxpayer beginning after December 31, 1986, with respect to interest expenses attributable to the excess of—

(I) the amount of the outstanding debt of the taxpayer on May 29, 1985, over

(II) the amount of the outstanding debt of the taxpayer on December 31, 1983,

paragraph (1) of section 864(e) of the Internal Revenue Code of 1986 (as added by this section) shall apply only to the applicable percentage (determined under the following table) of such interest expenses paid or accrued by the taxpayer during the taxable year:

In the case of the:	*The applicable percentage is:*
1st taxable year	*16⅔*
2nd taxable year	*33⅓*
3rd taxable year	*50*
4th taxable year	*66⅔*
5th taxable year	*83⅓*

(ii) INTEREST ATTRIBUTABLE TO INCREASE IN INDEBTEDNESS FROM JANUARY 1, 1983, THROUGH DECEMBER 31, 1983.—In the case of the first 4 taxable years of the taxpayer beginning after December 31, 1986, with respect to interest expenses attributable to the excess of—

(I) the amount of the outstanding debt of the taxpayer on January 1, 1984, over

(II) the amount of the outstanding debt of the taxpayer on December 31, 1982,

paragraph (1) of section 864(e) of the Internal Revenue Code of 1986 (as added by this section) shall apply only to the applicable percentage (determined under the following table) of such interest expenses paid or accrued by the taxpayer during the taxable year:

In the case of the:	*The applicable percentage is:*
1st taxable year	*20*
2nd taxable year	*40*
3rd taxable year	*60*
4th taxable year	*80.*

(iii) ORDERING RULE.—For purposes of this subparagraph, indebtedness outstanding on November 16, 1985, shall be treated as attributable first to any excess described in clause (i), then to any excess described in clause (ii), and then to other indebtedness.

(iv) TREATMENT OF AFFILIATED GROUP.—For purposes of this subparagraph, all members of the same affili-

ated group of corporations (as defined in section 864(e)(5)(A) of the Internal Revenue Code of 1986, as added by this section) shall be treated as one taxpayer whether or not such members filed a consolidated return.

(C) Special rule.—In the case of the first 9 taxable years beginning after December 31, 1986, the following applicable percentages shall be applied (in lieu of those set forth in subparagraph (A)) to interest expenses paid or accrued with respect to the amount of indebtedness described in subparagraph (D) or (E):

In the case of the:	*The applicable percentage is:*
1st taxable year	*10*
2nd taxable year	*20*
3rd taxable year	*30*
4th taxable year	*40*
5th taxable year	*50*
6th taxable year	*60*
7th taxable year	*70*
8th taxable year	*80*
9th taxable year	*90.*

(D) Indebtedness outstanding on May 29, 1985.—Indebtedness is described in this subparagraph if it is indebtedness (which was outstanding on May 29, 1985) of a corporation incorporated on June 13, 1917, which has its principal place of business in Bartlesville, Oklahoma.

(E) Indebtedness outstanding on May 29, 1985.—Indebtedness is described in this subparagraph if it is indebtedness (which was outstanding on May 29, 1985) of a member of an affiliated group (as defined in section 1504(a)), the common parent of which was incorporated on August 26, 1926, and has its principal place of business in Harrison, New York.

(3) Special rule.—

(A) In general.—In the case of a qualified corporation, in lieu of applying paragraph (2), the amendments made by this section shall not apply to interest expenses allocable to any indebtedness to the extent such indebtedness does not exceed $500,000,000 if—

(i) the indebtedness was incurred to develop or improve existing property that is owned by the taxpayer on November 16, 1985, and was acquired with the intent to develop or improve the property,

(ii) the loan agreement with respect to the indebtedness provides that the funds are to be utilized for purposes of developing or improving the above property, and

(iii) the debt to equity ratio of the companies that join in the filing of the consolidated return is less than 15 percent.

(B) Qualified corporation.—For purposes of subparagraph (A), the term "qualified corporation" means a corporation—

(i) which was incorporated in Delaware on June 29, 1964,

(ii) the principal subsidiary of which is a resident of Arkansas, and

(iii) which is a member of an affiliated group the average daily United States production of oil of which is less than 50,000 barrels and the average daily United States refining of which is less than 150,000 barrels.

(4) SPECIAL RULES FOR SUBSIDIARY.—The amendments made by this section shall not apply to interest on up to the applicable dollar amount of indebtedness of a subsidiary incorporated on February 11, 1975, the indebtedness of which on May 6, 1986, included—

(A) \$100,000,000 face amount of $11\frac{3}{4}$ *percent notes due in 1990,*

(B) \$100,000,000 of $8\frac{3}{4}$ *percent notes due in 1989,*

(C) $6\frac{3}{4}$ *percent Japanese yen notes due in 1991, and*

(D) $5\frac{3}{8}$ *percent Swiss franc bonds due in 1994.*

For purposes of this paragraph, the term "applicable dollar amount" means \$600,000,000 in the case of taxable years beginning in 1987 through 1991, \$500,000,000 in the case of the taxable year beginning in 1992, \$400,000,000 in the case of the taxable year beginning in 1993, \$300,000,000 in the case of the taxable year beginning in 1994, \$200,000,000 in the case of the taxable year beginning in 1995, \$100,000,000 in the case of the taxable year beginning in 1996, and zero in the case of taxable years beginning after 1996.

(5) SPECIAL RULE FOR FINANCIAL CORPORATION.—For purposes of section 864(e)(5) of the Internal Revenue Code of 1986 (as added by this section), a corporation shall be treated as described in subparagraph (C) of such section for any taxable year if—

(A) such corporation is a Delaware corporation incorporated on August 20, 1959, and

(B) such corporation was primarily engaged in the financing of dealer inventory or consumer purchases on May 29, 1985, and at all times thereafter before the close of the taxable year.

(6) SPECIAL RULES FOR ALLOCATING GENERAL AND ADMINISTRATIVE EXPENSES.—

(A) IN GENERAL.—In the case of an affiliated group of domestic corporations the common parent of which has its principal office in New Brunswick, New Jersey, and has a certificate of organization which was filed with the Secretary of the State of New Jersey on November 10, 1887, the amendments made by this section shall not apply to the phase-in percentage of general and administrative expenses paid or incurred in its 1st 3 taxable years beginning after December 31, 1986.

(B) PHASE-IN PERCENTAGE.—For purposes of subparagraph (A):

In the case of taxable years beginning in:	*The phase-in percentage is:*
1987	*75*
1988	*50*
1989	*25*

SEC. 1216. 1-YEAR MODIFICATION IN REGULATIONS PROVIDING FOR ALLOCATION OF RESEARCH AND EXPERIMENTAL EXPENDITURES.

(a) GENERAL RULE.—For purposes of section 861(b), section 862(b), and section 863(b) of the Internal Revenue Code of 1954, notwithstanding section 864(e) of such Code—

(1) 50 percent of all amounts allowable as a deduction for qualified research and experimental expenditures shall be apportioned to income from sources within the United States and deducted from such income in determining the amount of taxable income from sources within the United States, and

(2) the remaining portion of such amounts shall be apportioned on the basis of gross sales or gross income.

The preceding sentence shall not apply to any expenditures described in section 1.861-8(e)(3)(i)(B) of the Income Tax Regulations.

(b) QUALIFIED RESEARCH AND EXPERIMENTAL EXPENDITURES.—For purposes of this section—

(1) IN GENERAL.—The term "qualified research and experimental expenditures" means amounts—

(A) which are research and experimental expenditures within the meaning of section 174 of such Code, and

(B) which are attributable to activities conducted in the United States.

(2) TREATMENT OF DEPRECIATION, ETC.—Rules similar to the rules of section 174(c) of such Code shall apply.

(c) EFFECTIVE DATE.—This section shall apply to taxable years beginning after August 1, 1986, and on or before August 1, 1987.

Subtitle C—Taxation of Income Earned Through Foreign Corporations

SEC. 1221. INCOME SUBJECT TO CURRENT TAXATION.

(a) DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY INCOME.—

(1) IN GENERAL.—Subsection (c) of section 954 (defining foreign personal holding company income) is amended to read as follows:

"(c) FOREIGN PERSONAL HOLDING COMPANY INCOME.—

"(1) IN GENERAL.—For purposes of subsection (a)(1), the term 'foreign personal holding company income' means the portion of the gross income which consists of:

"(A) DIVIDENDS, ETC.—Dividends, interest, royalties, rents, and annuities.

"(B) CERTAIN PROPERTY TRANSACTIONS.—The excess of gains over losses from the sale or exchange of property—

"(i) which gives rise to income described in subparagraph (A) (after application of paragraph (2)(A)), or

"(ii) which does not give rise to any income.

This subparagraph shall not apply to gain from the sale or exchange of any property which, in the hands of the taxpayer, is property described in section 1221(1) or to gain from the sale or exchange of any property by a regular dealer in such property.

"(C) COMMODITIES TRANSACTIONS.—The excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodities. This subparagraph shall not apply to gains or losses which—

"(i) arise out of bona fide hedging transactions reasonably necessary to the conduct of any business by a producer, processor, merchant, or handler of a commodity in the manner in which such business is customarily and usually conducted by others,

"(ii) are active business gains or losses from the sale of commodities, but only if substantially all of the controlled foreign corporation's business is as an active producer, processor, merchant, or handler of commodities, or

"(iii) are foreign currency gains or losses (as defined in section 988(b)) attributable to any section 988 transactions.

"(D) FOREIGN CURRENCY GAINS.—The excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transactions. This subparagraph shall not apply in the case of any transaction directly related to the business needs of the controlled foreign corporation.

"(E) INCOME EQUIVALENT TO INTEREST.—Any income equivalent to interest, including income from commitment fees (or similar amounts) for loans actually made.

"(2) EXCEPTION FOR CERTAIN AMOUNTS.—

"(A) RENTS AND ROYALTIES DERIVED IN ACTIVE BUSINESS.—Foreign personal holding company income shall not include rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person (within the meaning of subsection (d)(3)).

"(B) CERTAIN EXPORT FINANCING.—Foreign personal holding company income shall not include any interest which is derived in the conduct of a banking business and which is export financing interest (as defined in section 904(d)(2)(G)).

"(3) CERTAIN INCOME RECEIVED FROM RELATED PERSONS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the term 'foreign personal holding company income' does not include—

"(i) dividends and interest received from a related person which (I) is created or organized under the laws of the same foreign country under the laws of which the controlled foreign corporation is created or organized, and (II) has a substantial part of its assets used in its trade or business located in such same foreign country, and

"(ii) rents and royalties received from a related person for the use of, or the privilege of using, property within the country under the laws of which the controlled foreign corporation is created or organized.

"(B) Exception not to apply to items which reduce subpart f income.—Subparagraph (A) shall not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty reduces the payor's subpart F income."

(2) Conforming amendment.—Subparagraph (A) of section 864(d)(5) (relating to certain provisions not to apply) is amended by striking out clauses (iii) and (iv) and inserting in lieu thereof the following:

"(iii) Subparagraph (B) of section 954(c)(2) (relating to certain export financing).

"(iv) Clause (i) of section 954(c)(3)(A) (relating to certain income received from related persons)."

(b) Definition of Insurance Income.—

(1) In general.—Subsection (a) of section 953 (defining income derived from the insurance of United States risks) is amended to read as follows:

"(a) General Rule.—For purposes of section 952(a)(1), the term 'insurance income' means any income which—

"(1) is attributable to the issuing (or reinsuring) of any insurance or annuity contract—

"(A) in connection with property in, liability arising out of activity in, or in connection with the lives or health of residents of, a country other than the country under the laws of which the controlled foreign corporation is created or organized, or

"(B) in connection with risks not described in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect of issuing (or reinsuring) a contract described in subparagraph (A), and

"(2) would (subject to the modifications provided by paragraphs (1) and (2) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance company."

(2) Special rule for certain captive insurance companies.—Section 953 is amended by adding at the end thereof the following new subsection:

"(c) Special Rule for Certain Captive Insurance Companies.—

"(1) In general.—For purposes only of taking into account related person insurance income—

"(A) the term 'United States shareholder' means, with respect to any foreign corporation, a United States person (as defined in section 957(c)) who owns (within the meaning of section 958(a)) any stock of the foreign corporation, and

"(B) the term 'controlled foreign corporation' has the meaning given to such term by section 957(a) determined by substituting '25 percent or more' for 'more than 50 percent'.

"(2) RELATED PERSON INSURANCE INCOME.—For purposes of this subsection, the term 'related person insurance income' means any insurance income attributable to a policy of insurance or reinsurance with respect to which the primary insured is a United States shareholder in the foreign corporation or a related person (within the meaning of section 954(d)(3)) to such a shareholder.

"(3) EXCEPTIONS.—

"(A) CORPORATIONS NOT HELD BY INSUREDS.—Paragraph (1) shall not apply to any foreign corporation if at all times during the taxable year of such foreign corporation—

"(i) less than 20 percent of the total combined voting power of all classes of stock of such corporation entitled to vote, and

"(ii) less than 20 percent of the total value of such corporation,

is owned (directly or indirectly under the principles of section 883(c)(4)) by persons who are the primary insured under any policy of insurance or reinsurance issued by such corporation or who are related persons (within the meaning of section 954(d)(3)) to any such primary insured.

"(B) DE MINIMIS EXCEPTION.—Paragraph (1) shall not apply to any foreign corporation for a taxable year of such corporation if the related person insurance income of such corporation for such taxable year is less than 20 percent of its insurance income for such taxable year determined without regard to those provisions of subsection (a)(1) which limit insurance income to income from countries other than the country in which the corporation was created or organized.

"(C) ELECTION TO TREAT INCOME AS EFFECTIVELY CONNECTED.—Paragraph (1) shall not apply to any foreign corporation for any taxable year if—

"(i) such corporation elects (at such time and in such manner as the Secretary may prescribe)—

"(I) to treat its related person insurance income for such taxable year as income effectively connected with the conduct of a trade or business in the United States, and

"(II) to waive all benefits with respect to related person insurance income under any income tax treaty between the United States and any foreign country, and

"(ii) such corporation meets such requirements as the Secretary shall prescribe to ensure that the tax imposed by this chapter on such income is paid.

"(D) SPECIAL RULES FOR SUBPARAGRAPH (C).—

"(i) ELECTION IRREVOCABLE.—Any election under subparagraph (C) shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

(ii) EXEMPTION FROM TAX IMPOSED BY SECTION 4371.—The tax imposed by section 4371 shall not apply with respect to any related person insurance income

treated as effectively connected with the conduct of a trade or business within the United States under subparagraph (C).

"(4) Treatment of mutual insurance companies.—In the case of a mutual insurance company—

"(A) this subsection shall apply,

"(B) policyholders of such company shall be treated as shareholders, and

"(C) appropriate adjustments in the application of this subpart shall be made under regulations prescribed by the Secretary.

"(5) Regulations.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection, including regulations preventing the avoidance of this subsection through cross insurance arrangements or otherwise."

(3) Conforming amendments.—

(A) Paragraph (1) of section 952(a) (defining subpart F income) is amended to read as follows:

"(1) insurance income (as defined under section 953),".

(B) Subsection (e) of section 954 is amended by striking out the last sentence.

(C) Subsection (b) of section 957 is amended by striking out "income derived from insurance of United States risks" and inserting in lieu thereof "insurance income".

(D) The section heading for section 953 is amended to read as follows:

"SEC. 953. INSURANCE INCOME."

(E) The table of sections for subpart F of part III of subchapter N of chapter 1 is amended by striking out the item relating to section 953 and inserting in lieu thereof the following:

"Sec. 953. Insurance income."

(c) Repeal of Exclusion for Reinvested Shipping Income.—

(1) In general.—Paragraph (2) of section 954(b) (relating to exclusion for reinvested shipping income) is hereby repealed.

(2) Space and certain ocean activities included.—Subsection (f) of section 954 (defining foreign base company shipping income) is amended by adding at the end thereof the following new sentence:

"Such term includes any income derived from a space or ocean activity (as defined in section 863(d)(2))."

(3) Conforming amendments.—

(A)(i) Section 954 is amended by striking out subsection (g) and by redesignating subsection (h) as subsection (g).

(ii) Paragraph (5) of section 954(a) is amended by striking out "determined under subsection (h)" and inserting in lieu thereof "determined under subsection (g)".

(B) Subparagraph (A) of section 955(a)(1) is amended by striking out "all prior taxable years" and inserting in lieu thereof "all prior taxable years beginning before 1987".

(C) Subparagraph (A) of section 955(a)(2) is amended by striking out "at the close of the preceding taxable year"

and inserting in lieu thereof "as of the close of the last taxable year beginning before 1987".

(d) Exception Where Foreign Corporation Not Availed of To Reduce Tax.—Paragraph (4) of section 954(b) (relating to exception for foreign corporations not availed of to reduce taxes) is amended to read as follows:

"(4) Exception for certain income subject to high foreign taxes.—For purposes of subsection (a) and section 953, foreign base company income and insurance income shall not include any item of income received by a controlled foreign corporation if the taxpayer establishes to the satisfaction of the Secretary that such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in section 11. The preceding sentence shall not apply to foreign base company oil-related income described in subsection (a)(5)."

(e) Definition of Related Person.—

(1) Paragraph (3) of section 954(d) (defining related person) is amended by striking out subparagraphs (A), (B), and (C), and inserting in lieu thereof the following:

"(A) such person is an individual, corporation, partnership, trust, or estate which controls, or is controlled by, the controlled foreign corporation, or

"(B) such person is a corporation, partnership, trust, or estate which is controlled by the same person or persons which control the controlled foreign corporation."

(2) Paragraph (3) of section 954(d) is amended by striking out the last 2 sentences and inserting in lieu thereof the following: "For purposes of the preceding sentence, control means, with respect to a corporation, the ownership, directly or indirectly, of stock possessing 50 percent or more of the total voting power of all classes of stock entitled to vote or of the total value of stock of such corporation. In the case of a partnership, trust, or estate, control means the ownership, directly or indirectly, of 50 percent or more (by value) of the beneficial interests in such partnership, trust, or estate. For purposes of this paragraph, rules similar to the rules of section 958 shall apply."

(f) Repeal of Certain Limitations on Amount of Subpart F Income.—Section 952 (defining subpart F income) is amended by striking out subsections (c) and (d) and inserting in lieu thereof the following:

"(c) Limitation.—

"(1) In general.—

"(A) Subpart F income limited to current earnings and profits.—For purposes of subsection (a), the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such taxable year

"(B) Certain prior year deficits may be taken into account.—

"(i) In general.—The amount included in the gross income of any United States shareholder under section 951(a)(1)(A)(i) for any taxable year and attributable to a qualified activity shall be reduced by the amount of

such shareholder's pro rata share of any qualified deficit.

"(ii) QUALIFIED DEFICIT.—The term 'qualified deficit' means any deficit in earnings and profits of the controlled foreign corporation for any prior taxable year which began after December 31, 1986, and for which the controlled foreign corporation was a controlled foreign corporation; but only to the extent such deficit—

"(I) is attributable to the same qualified activity as the activity giving rise to the income being offset, and

"(II) has not previously been taken into account under this subparagraph.

"(iii) QUALIFIED ACTIVITY.—For purposes of this paragraph, the term 'qualified activity' means any activity giving rise to—

"(I) foreign base company shipping income,

"(II) foreign base company oil related income,

"(III) in the case of a qualified insurance company, insurance income or

"(IV) in the case of a qualified financial institution, foreign personal holding company income.

"(iv) PRO RATE SHARE.—For purposes of this paragraph, the shareholder's pro rata share of any deficit for any prior taxable year shall be determined under rules similar to rules under section 951(a)(2) for whichever of the following yields the smaller share:

"(I) the close of the taxable year, or

"(II) the close of the taxable year in which the deficit arose.

"(v) QUALIFIED INSURANCE COMPANY.—For purposes of this subparagraph, the term 'qualified insurance company' means any controlled foreign corporation predominantly engaged in the active conduct of an insurance business in the taxable year and in the prior taxable years in which the deficit arose.

"(vi) QUALIFIED FINANCIAL INSTITUTION.—For purposes of this paragraph, the term 'qualified financial institution' means any controlled foreign corporation predominantly engaged in the active conduct of a banking, financing, or similar business in the taxable year and in the prior taxable year in which the deficit arose.

"(2) RECHARACTERIZATION IN SUBSEQUENT TAXABLE YEARS.—If the subpart F income of any controlled foreign corporation for any taxable year was reduced by reason of paragraph (1)(A), any excess of the earnings and profits of such corporation for any subsequent taxable year over the subpart F income of such foreign corporation for such taxable year shall be recharacterized as subpart F income under rules similar to the rules applicable under section 904(f)(5)."

(g) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, the amendments made by this section shall apply to tax-

able years of foreign corporations beginning after December 31, 1986.

(2) SPECIAL RULE FOR REPEAL OF EXCLUSION FOR REINVESTMENT SHIPPING INCOME.—

(A) IN GENERAL.—In the case of any qualified controlled foreign corporation—

(i) the amendments made by subsection (c) shall apply to taxable years ending on or after January 1, 1992, and

(ii) sections 955(a)(1)(A) and 955(a)(2)(A) of the Internal Revenue Code of 1986 (as amended by subsection (c)(3) shall be applied by substituting "ending before 1992" for "beginning before 1987".

(B) QUALIFIED CONTROLLED FOREIGN CORPORATION.—For purposes of subparagraph (A), the term "qualified controlled foreign corporation" means any controlled foreign corporation (as defined in section 957 of such Code)—

(i) if the United States agent of such corporation is a domestic corporation incorporated on March 13, 1951, and

(ii) if—

(I) the certificate of incorporation of such corporation is dated July 23, 1963, and

(II) such corporation has a wholly owned subsidiary and its certificate of incorporation is dated November 2, 1965.

(3) EXCEPTION FOR CERTAIN REINSURANCE CONTRACTS.—

(A) IN GENERAL.—In the case of the 1st 3 taxable years of a qualified controlled foreign insurer beginning after December 31, 1986, the amendments made by this section shall not apply to the phase-in percentage of any qualified reinsurance income.

(B) PHASE-IN PERCENTAGE.—For purposes of subparagraph (A):

In the case of taxable years beginning in:	***The phase-in percentage is:***
1987	*75*
1988	*50*
1989	*25*

(C) QUALIFIED CONTROLLED FOREIGN INSURER.—For purposes of this paragraph, the term "qualified controlled foreign insurer" means—

(i) any controlled foreign corporation which on August 16, 1986, was a member of an affiliated group (as defined in section 1504(a) of the Internal Revenue Code of 1986 without regard to subsection (b)(3) thereof) which had as its common parent a corporation incorporated in Delaware on July 9, 1967, with executive offices in New York, New York, or

(ii) any controlled foreign corporation which on August 16, 1986, was a member of an affiliated group (as so defined) which had as its common parent a corporation incorporated in Delaware on March 31, 1982, with executive offices in Philadelphia, Pennsylvania.

(D) Qualified reinsurance income.—For purposes of this paragraph, the term 'qualified reinsurance income' means any insurance income attributable tl risks (other than risk described in section 953(a) or 954(e) of such Code as in effect on the day before the date of the enactment of this Act) assumed as of August 16, 1986, under a reinsurance contract in effect on such date. For purposes of the preceding sentence, insurance income shall mean the underwriting income (as defined in section 832(b)(3) of such Code) and investment income derived from an amount of assets (to be segregated and separately identified) equivalent to the ordinary and necessary insurance reserves and necessary surplus equal to ⅓ of earned premium attributable to such contracts.

SEC. 1222. TESTING CONTROLLED FOREIGN CORPORATIONS AND FOREIGN PERSONAL HOLDING COMPANIES BY VALUE AND VOTING POWER.

(a) Definition of Controlled Foreign Corporation.—

(1) In general.—Subsection (a) of section 957 (defining controlled foreign corporation) is amended to read as follows:

"(a) General Rule.—For purposes of this subpart, the term 'controlled foreign corporation' means any foreign corporation if more than 50 percent of—

"(1) the total combined voting power of all classes of stock of such corporation entitled to vote, or

"(2) the total value of the stock of such corporation,

is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation."

(2) Special rule for insurance.—Subsection (b) of section 957 is amended by striking out "all classes of stock" and inserting in lieu thereof "all classes of stock (or more than 25 percent of the total value of stock)".

(b) Definition of Foreign Personal Holding Company.—Paragraph (2) of section 552(a) (defining foreign personal holding company) is amended to read as follows:

"(2) Stock ownership requirement.—At any time during the taxable year more than 50 percent of—

"(A) the total combined voting power of all classes of stock of such corporation entitled to vote, or

"(B) the total value of the stock of such corporation,

is owned (directly or indirectly) by or for not more than 5 individuals who are citizens or residents of the United States (hereinafter in this part referred to as the 'United States group')."

(c) Effective Date.—

(1) In general.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 1986; except that for purposes of applying sections 951(a)(1)(B) and 956 of the Internal Revenue Code of 1986, such amendments shall take effect on August 16, 1986.

(2) Transitional rule.—In the case of any corporation treated as a controlled foreign corporation by reason of the amendments made by this section, property acquired before August 16,

1986, shall not be taken into account under section 956(b) of the Internal Revenue Code of 1986.

(3) SPECIAL RULE FOR BENEFICIARY OF TRUST.—In the case of an individual—

(A) who is a beneficiary of a trust which was established on December 7, 1979, under the laws of a foreign jurisdiction, and

(B) who was not a citizen or resident of the United States on the date the trust was established,

amounts which are included in the gross income of such beneficiary under section 951(a) of the Internal Revenue Code of 1986 with respect to stock held by the trust (and treated as distributed to the trust) shall be treated as the first amounts which are distributed by the trust to such beneficiary and as amounts to which section 959(a) of such Code applies.

SEC. 1223. SUBPART F DE MINIMIS RULE.

(a) GENERAL RULE.—Paragraph (3) of section 954(b) (relating to special rule where foreign base company income is less than 10 percent or more than 70 percent of gross income) is amended to read as follows:

"(3) DE MINIMIS, ETC., RULES.—For purposes of subsection (a) and section 953—

"(A) DE MINIMIS RULE.—If the sum of foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year is less than the lesser of—

"(i) 5 percent of gross income, or

"(ii) $1,000,000,

no part of the gross income for the taxable year shall be treated as foreign base company income or insurance income.

"(B) FOREIGN BASE COMPANY INCOME AND INSURANCE INCOME IN EXCESS OF 70 PERCENT OF GROSS INCOME.—If the sum of the foreign base company income (determined without regard to paragraph (5)) and the gross insurance income for the taxable year exceeds 70 percent of gross income, the entire gross income for the taxable year shall, subject to the provisions of paragraphs (4) and (5), be treated as foreign base company income or insurance income (whichever is appropriate).

"(C) GROSS INSURANCE INCOME.—For purposes of subparagraphs (A) and (B), the term 'gross insurance income' means any item of gross income taken into account in determining insurance income under section 953."

(b) TECHNICAL AMENDMENTS.—

(1) Clause (ii) of section 864(d)(5)(A) is amended by striking out "less than 10 percent" and inserting in lieu thereof "less than 5 percent or $1,000,000".

(2) Clause (i) of section 881(c)(4)(A) is amended by striking out "less than 10 percent" and inserting in lieu thereof "less than 5 percent or $1,000,000".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1224. REPEAL OF SPECIAL TREATMENT OF POSSESSIONS CORPORATIONS.

(a) GENERAL RULE.—Section 957 (defining controlled foreign corporations; United States persons) is amended by striking out subsection (c) and by redesignating subsection (d) as subsection (c).

(b) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendment made by subsection (a) shall apply to taxable years of foreign corporations beginning after December 31, 1986; except that for purposes of applying sections 951(a)(1)(B) and 956 of the Internal Revenue Code of 1986, such amendments shall take effect on August 16, 1986.

(2) TRANSITIONAL RULE.—In the case of any corporation treated as a controlled foreign corporation by reason of the amendment made by subsection (a), property acquired before August 16, 1986, shall not be taken into account under section 956(b) of the Internal Revenue Code of 1986.

SEC. 1225. ONLY EFFECTIVELY CONNECTED CAPITAL GAINS AND LOSSES OF FOREIGN CORPORATIONS TAKEN INTO ACCOUNT FOR PURPOSES OF ACCUMULATED EARNINGS TAX AND PERSONAL HOLDING COMPANY PROVISIONS.

(a) ACCUMULATED EARNINGS TAX.—Subsection (b) of section 535 (relating to adjustments to taxable income) is amended by adding at the end thereof the following new paragraph:

"(9) SPECIAL RULE FOR CAPITAL GAINS AND LOSSES OF FOREIGN CORPORATIONS.—In the case of a foreign corporation, paragraph (6) shall be applied by taking into account only gains and losses which are effectively connected with the conduct of a trade or business within the United States and are not exempt from tax under treaty."

(b) PERSONAL HOLDING COMPANY PROVISIONS.—Subsection (b) of section 545 (relating to adjustments to taxable income) is amended by adding at the end thereof the following new paragraph:

"(7) SPECIAL RULE FOR CAPITAL GAINS AND LOSSES OF FOREIGN CORPORATIONS.—In the case of a foreign corporation, paragraph (5) shall be applied by taking into account only gains and losses which are effectively connected with the conduct of a trade or business within the United States and are not exempt from tax under treaty."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to gains and losses realized on or after March 1, 1986.

SEC. 1226. DEDUCTIONS FOR DIVIDENDS RECEIVED FROM CERTAIN FOREIGN CORPORATIONS.

(a) GENERAL RULE.—Subsection (a) of section 245 is amended to read as follows:

"(a) DIVIDENDS FROM 10-PERCENT OWNED FOREIGN CORPORATIONS.—

"(1) IN GENERAL.—In the case of dividends received by a corporation from a qualified 10-percent owned foreign corporation, there shall be allowed as a deduction an amount equal to the percent (specified in section 243 for the taxable year) of the U.S.-source portion of such dividends.

"(2) QUALIFIED 10-PERCENT OWNED FOREIGN CORPORATION.—For purposes of this subsection, the term 'qualified 10-percent owned foreign corporation' means any foreign corporation (other

than a foreign personal holding company passive foreign investment company) if at least 10 percent of the stock of such corporation (by vote and value) is owned by the taxpayer.

"(3) U.S.-SOURCE PORTION.—For purposes of this subsection, the U.S.-source portion of any dividend is an amount which bears the same ratio to such dividend as—

"(A) the post-1986 undistributed U.S. earnings, bears to

"(B) the total post-1986 undistributed earnings.

"(4) POST-1986 UNDISTRIBUTED EARNINGS.—For purposes of this subsection, the term 'post-1986 undistributed earnings' has the meaning given to such term by section 902(c)(1).

"(5) POST-1986 UNDISTRIBUTED U.S. EARNINGS.—For purposes of this subsection, the term 'post-1986 undistributed U.S. earnings' means the portion of the post-1986 undistributed earnings which is attributable to—

"(A) income of the qualified 10-percent owned foreign corporation which is effectively connected with the conduct of a trade or business within the United States and subject to tax under this chapter, or

"(B) any dividend received (directly or through a wholly owned foreign corporation) from a domestic corporation at least 80 percent of the stock of which (by vote and value) is owned (directly or through such wholly owned foreign corporation) by the qualified 10-percent owned foreign corporation.

"(6) SPECIAL RULE.—If the 1st day on which the requirements of paragraph (2) are met with respect to any foreign corporation is in a taxable year of such corporation beginning after December 31, 1986, the post-1986 undistributed earnings and the post-1986 undistributed U.S. earnings of such corporation shall be determined by only taking into account periods beginning on and after the 1st day of the 1st taxable year in which such requirements are met.

"(7) COORDINATION WITH SUBSECTION (b).—Earnings and profits of any qualified 10-percent owned foreign corporation for any taxable year shall not be taken into account under this subsection if the deduction provided by subsection (b) would be allowable with respect to dividends paid out of such earnings and profits.

"(8) COORDINATION WITH SECTION 902.—In the case of a dividend received by a corporation from a qualified 10-percent owned foreign corporation, no credit shall be allowed under section 901 for any taxes treated as paid under section 902 with respect to the U.S.-source portion of such dividend.

"(9) COORDINATION WITH SECTION 904.—For purposes of section 904, the U.S.-source portion of any dividend received by a corporation from a qualified 10-percent owned foreign corporation shall be treated as from sources in the United States."

(b) TECHNICAL AMENDMENT.—Subsection (d) of section 959 is amended by striking out the period at the end thereof and inserting in lieu thereof "; except that such distributions shall immediately reduce earnings and profits."

(c) EFFECTIVE DATES.—

(1) In general.—The amendment made by subsection (a) shall apply to distributions out of earnings and profits for taxable years beginning after December 31, 1986.

(2) Subsection (b).—The amendment made by subsection (b) shall apply to distributions after the date of the enactment of this Act.

SEC. 1227. SPECIAL RULE FOR APPLICATION OF SECTION 954 TO CERTAIN DIVIDENDS.

(a) In General.—For purposes of section 954(c)(3)(A) of the Internal Revenue Code of 1986, any dividends received by a qualified controlled foreign corporation (within the meaning of section 951 of such Code) during any of its last 5 taxable years beginning after December 31, 1986, with respect to its 32.7 percent interest in a Brazilian corporation shall be treated as if such Brazilian corporation were a related person to the qualified controlled foreign corporation to the extent the Brazilian corporation's income is attributable to its interest in the trade or business of mining in Brazil.

(b) Quality Controlled Foreign Corporation.—For purposes of this section, a qualified controlled foreign corporation is a corporation the greater than 99 percent shareholder of which is a company originally incorporated in Montana on July 9, 1951 (the name of which was changed on August 10, 1966).

(c) Effective Date.—The amendment made by this section shall apply to dividends received after December 31, 1986.

SEC. 1228. SPECIAL RULE FOR APPLYING SECTION 897.

(a) In General.—For purposes of section 897 of the Internal Revenue Code of 1986, gain shall not be recognized on the transfer, sale, exchange, or other disposition, of shares of stock of a United States real property holding company, if—

(1) such United States real property holding company is a Delaware corporation incorporated on January 17, 1984,

(2) the transfer, sale, exchange, or other disposition is to any member of a qualified ownership group,

(3) the recipient of the share of stock elects, for purposes of such section 897, a carryover basis in the transferred shares, and

(4) an election under this section applies to such transfer, sale, exchange, or other disposition.

(b) Member of a Qualified Ownership Group.—For purposes of this section, the term "member of a qualified ownership group" means a corporation incorporated on June 16, 1890, under the laws of the Netherlands or a corporation incorporated on October 18, 1897, under the laws of the United Kingdom or any corporation owned directly or indirectly by either or both such corporations.

(c) Election.—An election under this section shall be made at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe, and an election under this section may only be made with respect to 1 transfer, sale, exchange, or other disposition.

(d) Effective Date.—The provisions of this section shall take effect on the date of the enactment of this section.

Subtitle D—Special Tax Provisions for United States Persons

SEC. 1231. MODIFICATIONS TO SECTION 936.

(a) Treatment of Intangibles.—

(1) Cost sharing method.—Section 936(h)(5)(C)(i)(I) is amended—

(A) by striking out "the same proportion of the cost" and inserting in lieu thereof "the same proportion of 110 percent of the cost", and

(B) by adding at the end thereof the following new sentence: "In the case of intangible property described in subsection (h)(3)(B)(i) which the electing corporation is treated as owning under subclause (II), in no event shall the payment required under this subclause be less than the inclusion or payment which would be required under section 367(d)(2)(A)(ii) or section 482 if the electing corporation were a foreign corporation."

(2) Profit split method.—Section 936(h)(5)(C)(ii)(II) is amended by striking out "the third sentence thereof)" and inserting in lieu thereof "the third and fourth sentences thereof, but substituting '120 percent' for '110 percent' in the second sentence thereof)".

(b) Modification of Requirement That Amounts Be Received in the United States.—Subsection (b) of section 936 is amended by adding at the end thereof the following new sentence: "This subsection shall not apply to any amount described in subsection (a)(1)(A)(i) received from a person who is not a related person (within the meaning of subsection (h)(3) but without regard to subparagraphs (D)(ii)(I) and (E)(i) thereof) with respect to the domestic corporation."

(c) Treatment of Certain Investment Income as Qualified Possession Source Investment Income.—Subsection (d) of section 936 is amended by adding at the end thereof the following new paragraph:

"(4) Investment in qualified Caribbean basin countries.—

"(A) In general.—For purposes of paragraph (2)(B), an investment in a financial institution shall, subject to such conditions as the Secretary may prescribe by regulations, be treated as for use in Puerto Rico to the extent used by such financial institution (or by the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank)—

"(i) for investment, consistent with the goals and purposes of the Caribbean Basin Economic Recovery Act, in—

"(I) active business assets in a qualified Caribbean Basin country, or

"(II) development projects in a qualified Caribbean Basin country, and

"(ii) in accordance with a specific authorization granted by the Government Development Bank for Puerto Rico pursuant to regulations issued by the Secretary of the Treasury of Puerto Rico.

A similar rule shall apply in the case of a direct investment in the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank.

"(B) QUALIFIED CARIBBEAN BASIN COUNTRY.—For purposes of this subsection, the term 'qualified Caribbean Basin country' means any beneficiary country (within the meaning of section 212(a)(1)(A) of the Caribbean Basin Economic Recovery Act) which meets the requirements of clauses (i) and (ii) of section 274(h)(6)(A).

"(C) ADDITIONAL REQUIREMENTS.—Subparagraph (A) shall not apply to any investment made by a financial institution (or by the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank) unless—

"(i) the person in whose trade or business such investment is made (or such other recipient of the investment) and the financial institution or such Bank certify to the Secretary and the Secretary of the Treasury of Puerto Rico that the proceeds of the loan will be promptly used to acquire active business assets or to make other authorized expenditures, and

"(ii) the financial institution (or the Government Development Bank for Puerto Rico or the Puerto Rico Economic Development Bank) and the recipient of the investment funds agree to permit the Secretary and the Secretary of the Treasury of Puerto Rico to examine such of their books and records as may be necessary to ensure that the requirements of this paragraph are met."

(d) INCREASE IN AMOUNT OF GROSS INCOME WHICH MUST BE FROM TRADE OR BUSINESS.—

(1) IN GENERAL.—Subparagraph (B) of section 936(a)(2) is amended by striking out "65 percent" and inserting in lieu thereof "75 percent".

(2) CONFORMING AMENDMENT.—Paragraph (2) of section 936(a) is amended by striking out subparagraph (C).

(e) TREATMENT OF CERTAIN ROYALTY PAYMENTS.—

(1) IN GENERAL.—Section 482 (relating to allocation of income and deductions among taxpayers) is amended by adding at the end thereof the following new sentence: "In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible."

(2) TECHNICAL AMENDMENT.—Subparagraph (A) of section 367(d)(2) (relating to transfers of intangibles treated as transfer pursuant to sale for contingent payments) is amended by adding at the end thereof the following new sentence:

"The amounts taken into account under clause (ii) shall be commensurate with the income attributable to the intangible."

(f) Technical Correction to Profit-Split Rules.—The last sentence of section 936(h)(5)(C)(ii)(II) is amended by striking out "all products produced and types of service rendered" and inserting in lieu thereof "all products and types of services, within such product area, produced or rendered".

(g) Effective Dates.—

(1) In general.—Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Special rule for transfer of intangibles.—

(A) In general.—The amendments made by subsection (e) shall apply to taxable years beginning after December 31, 1986, but only with respect to transfers after November 16, 1985, or licenses granted after such date (or before such date with respect to property not in existence or owned by the taxpayer on such date).

(B) Special rule for section 936.—For purposes of section 936(h)(5)(C) of the Internal Revenue Code of 1986 the amendments made by subsection (e) shall apply to taxable years beginning after December 31, 1986, without regard to when the transfer (or license) was made.

(3) Subsection (f).—The amendment made by subsection (f) shall apply to taxable years beginning after December 31, 1982.

(4) Transitional rule.—In the case of a corporation—

(A) with respect to which an election under section 936 of the Internal Revenue Code of 1986 (relating to possessions tax credit) is in effect,

(B) which produced an end-product form in Puerto Rico on or before September 3, 1982,

(C) which began manufacturing a component of such product in Puerto Rico in its taxable year beginning in 1983, and

(D) with respect to which a Puerto Rican tax exemption was granted on June 27, 1983,

such corporation shall treat such component as a separate product for such taxable year for purposes of determining whether such corporation had a significant business presence in Puerto Rico with respect to such product and its income with respect to such product.

SEC. 1232. TREATMENT OF CERTAIN PERSONS IN PANAMA.

(a) General Rule.—Nothing in the Panama Canal Treaty (or in any agreement implementing such Treaty) shall be construed as exempting (in whole or in part) any citizen or resident of the United States from any tax under the Internal Revenue Code of 1954 or 1986. The preceding sentence shall apply to all taxable years whether beginning before, on, or after the date of the enactment of this Act (or in the case of any tax not imposed with respect to a taxable year, to taxable events after the date of enactment of this Act.)

(b) Treatment of Employees of Panama Canal Commission and Department of Defense for Purposes of Section 912.—Em-

ployees of the Panama Canal Commission and civilian employees of the Defense Department of the United States stationed in Panama may exclude from gross income allowances which are comparable to the allowances excludable under section 912(1) of the Internal Revenue Code of 1986 by employees of the State Department of the United States stationed in Panama. The preceding sentence shall apply to taxable years beginning after December 31, 1986.

SEC. 1233. PROVISIONS RELATING TO SECTION 911 EXCLUSION.

(a) REDUCTION IN SECTION 911 EXCLUSION.—Subparagraph (A) of section 911(b)(2) (relating to limitation on foreign earned income) is amended to read as follows:

> *"(A) IN GENERAL.—The foreign earned income of an individual which may be excluded under subsection (a)(1) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate of $70,000."*

(b) SECTION 911 EXCLUSION NOT AVAILABLE TO INDIVIDUALS VIOLATING FEDERAL TRAVEL AND OTHER RESTRICTIONS.—Section 911(d) (relating to definitions and special rules) is amended by redesignating paragraph (8) as paragraph (9) and by inserting after paragraph (7) the following new paragraph:

> *"(8) LIMITATION ON INCOME EARNED IN RESTRICTED COUNTRY.—*
>
> *"(A) IN GENERAL.—If travel (or any transaction in connection with such travel) with respect to any foreign country is subject to the regulations described in subparagraph (B) during any period—*
>
> *"(i) the term 'foreign earned income' shall not include any income from sources within such country attributable to services performed during such period,*
>
> *"(ii) the term 'housing expenses' shall not include any expenses allocable to such period for housing in such country or for housing of the spouse or dependents of the taxpayer in another country while the taxpayer is present in such country, and*
>
> *"(iii) an individual shall not be treated as a bona fide resident of, or as present in, a foreign country for any day during which such individual was present in such country during such period.*
>
> *"(B) REGULATIONS.—For purposes of this paragraph, regulations are described in this subparagraph if such regulations—*
>
> *"(i) have been adopted pursuant to the Trading With the Enemy Act (50 U.S.C. App. 1 et seq.), or the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.), and*
>
> *"(ii) include provisions generally prohibiting citizens and residents of the United States from engaging in transactions related to travel to, from, or within a foreign country.*
>
> *"(C) EXCEPTION.—Subparagraph (A) shall not apply to any individual during any period in which such individ-*

ual's activities are not in violation of the regulations described in subparagraph (B).''

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1234. FOREIGN COMPLIANCE PROVISIONS.

(a) Information Returns.—

(1) In general.—Subpart A of part III of subchapter A of chapter 61 (relating to information concerning persons subject to special provisions) is amended by inserting after section 6039D the following new section:

''SEC. 6039E. INFORMATION CONCERNING RESIDENT STATUS.

''(a) General Rule.—Notwithstanding any other provision of law, any individual who—

''(1) applies for a United States passport (or a renewal thereof), or

''(2) applies to be lawfully accorded the privilege of residing permanently in the United States as an immigrant in accordance with the immigration laws,

shall include with any such application a statement which includes the information described in subsection (b).

''(b) Information To Be Provided.—Information required under subsection (a) shall include—

''(1) the taxpayer's TIN (if any),

''(2) in the case of a passport applicant, any foreign country in which such individual is residing,

''(3) in the case of an individual seeking permanent residence, information with respect to whether such individual is required to file a return of the tax imposed by chapter 1 for such individual's most recent 3 taxable years, and

''(4) such other information as the Secretary may prescribe.

''(c) Penalty.—Any individual failing to provide a statement required under subsection (a) shall be subject to a penalty equal to $500 for each such failure, unless it is shown that such failure is due to reasonable cause and not to willful neglect.

''(d) Information To Be Provided to Secretary.—Notwithstanding any other provision of law, any agency of the United States which collects (or is required to collect) the statement under subsection (a) shall—

''(1) provide any such statement to the Secretary, and

''(2) provide to the Secretary the name (and any other identifying information) of any individual refusing to comply with the provisions of subsection (a).

''(e) Exemption.—The Secretary may by regulations exempt any class of individuals from the requirements of this section if he determines that applying this section to such individuals is not necessary to carry out the purposes of this section.''

(2) Conforming amendment.—The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by inserting after the item relating to section 6039D the following new item:

''Sec. 6039E. Information concerning resident status.''

(3) Effective date.—The amendments made by this subsection shall apply to applications submitted after December 31, 1987 (or, if earlier, the effective date (which shall not be earlier than January 1, 1987) of the initial regulations issued under section 6039E of the Internal Revenue Code of 1986 as added by this subsection).

(b) Withholding on Certain Deferred Payments Outside the United States.—

(1) In general.—Subsection (d) of section 3405 (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(13) Election may not be made with respect to certain payments outside the United States.—

"(A) In general.—Except as provided in subparagraph (B), in the case of any periodic payment or nonperiodic distribution which is to be delivered outside of the United States, no election may be made under subsection (a)(2) or (b)(3) with respect to such payment.

"(B) Exception.—Subparagraph (A) shall not apply if the recipient certifies to the payor, in such manner as the Secretary may prescribe, that such person is not—

"(i) a United States citizen who is a bona fide resident of a foreign country, or

"(ii) an individual to whom section 877 applies."

(2) Effective date.—The amendment made by this subsection shall apply to payments after December 31, 1986.

SEC. 1235. TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES.

(a) General Rule.—Subchapter P of chapter 1 is amended by adding at the end thereof the following new part:

"PART VI—TREATMENT OF CERTAIN PASSIVE FOREIGN INVESTMENT COMPANIES

"Subpart A. Interest on tax deferral.
"Subpart B. Treatment of qualified electing funds.
"Subpart C. General provisions.

"Subpart A—Interest on Tax Deferral

"Sec. 1291. Interest on tax deferral.

"SEC. 1291. INTEREST ON TAX DEFERRAL.

"(a) Treatment of Distributions and Stock Dispositions.—

"(1) Distributions.—If a United States person receives an excess distribution in respect of stock in a passive foreign investment company, then—

"(A) the amount of the excess distribution shall be allocated ratably to each day in the taxpayer's holding period for the stock,

"(B) with respect to such excess distribution, the taxpayer's gross income for the current year shall include (as ordinary income) only the amounts allocated under subparagraph (A) to—

"(i) the current year, or

"(ii) any period in the taxpayer's holding period before the 1st day of the 1st taxable year of the company for which it was a passive foreign investment company (or, if later, January 1, 1987), and

"(C) the tax imposed by this chapter for the current year shall be increased by the deferred tax amount (determined under subsection (c)).

"(2) DISPOSITIONS.—If the taxpayer disposes of stock in a passive foreign investment company, then the rules of paragraph (1) shall apply to any gain recognized on such disposition in the same manner as if such gain were an excess distribution.

"(3) DEFINITIONS.—For purposes of this section—

"(A) HOLDING PERIOD.—The taxpayer's holding period shall be determined under section 1223; except that, in the case of an excess distribution, such holding period shall be treated as ending on the date of such distribution.

"(B) CURRENT YEAR.—The term 'current year' means the taxable year in which the excess distribution or disposition occurs.

"(4) COORDINATION WITH SECTION 904.—Subparagraph (B) of paragraph (1) shall not apply for purposes of section 904.

"(5) SECTION 902 NOT TO APPLY.—Section 902 shall not apply to any dividend paid by a passive foreign investment company unless such company is a qualified electing fund.

"(b) EXCESS DISTRIBUTION.—

"(1) IN GENERAL.—For purposes of this section, the term 'excess distribution' means any distribution in respect of stock received during any taxable year to the extent such distribution does not exceed its ratable portion of the total excess distribution (if any) for such taxable year.

"(2) TOTAL EXCESS DISTRIBUTION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'total excess distribution' means the excess (if any) of—

"(i) the amount of the distributions in respect of the stock received by the taxpayer during the taxable year, over

"(ii) 125 percent of the average amount received in respect of such stock by the taxpayer during the 3 preceding taxable years (or, if shorter, the portion of the taxpayer's holding period before the taxable year).

"(B) NO EXCESS FOR 1ST YEAR.—The total excess distributions with respect to any stock shall be zero for the taxable year in which the taxpayer's holding period in such stock begins.

"(3) ADJUSTMENTS.—Under regulations prescribed by the Secretary—

"(A) determinations under this subsection shall be made on a share-by-share basis, except that shares with the same holding period may be aggregated,

"(B) proper adjustments shall be made for stock splits and stock dividends,

"(C) if the taxpayer does not hold the stock during the entire taxable year, distributions received during such year shall be annualized,

"(D) if the taxpayer's holding period includes periods during which the stock was held by another person, distributions received by such other person shall be taken into account as if received by the taxpayer, and

"(E) if the distributions are received in a foreign currency, determinations under this subsection shall be made in such currency and the amount of any excess distribution determined in such currency shall be translated into dollars.

"(c) DEFERRED TAX AMOUNT.—For purposes of this section—

"(1) IN GENERAL.—The term 'deferred tax amount' means, with respect to any distribution or disposition to which subsection (a) applies, an amount equal to the sum of—

"(A) the aggregate increases in taxes described in paragraph (2), plus

"(B) the aggregate amount of interest (determined in the manner provided under paragraph (3)) on such increases in tax.

"(2) AGGREGATE INCREASES IN TAXES.—For purposes of paragraph (1)(A), the aggregate increases in taxes shall be determined by multiplying each amount allocated under subsection (a)(1)(A) to any taxable year (other than any taxable year referred to in subsection (a)(1)(B)) by the highest rate of tax in effect for such taxable year under section 1 or 11, whichever applies.

"(3) COMPUTATION OF INTEREST.—

"(A) IN GENERAL.—The amount of interest referred to in paragraph (1)(B) on any increase determined under paragraph (2) for any taxable year shall be determined for the period—

"(i) beginning on the due date for such taxable year, and

"(ii) ending on the due date for the taxable year with or within which the distribution or disposition occurs,

by using the rates and method applicable under section 6621 for underpayments of tax for such period.

"(B) DUE DATE.—For purposes of this subsection, the term 'due date' means the date prescribed by law (determined without regard to extensions) for filing the return of the tax imposed by this chapter for the taxable year.

"(d) COORDINATION WITH SUBPART B.—

"(1) IN GENERAL.—This section shall not apply with respect to—

"(A) any distribution paid by a passive foreign investment company during a taxable year for which such company is a qualified electing fund, and

"(B) any disposition of stock in a passive foreign investment company if such company is a qualified electing fund for each of its taxable years—

"(i) which begins after December 31, 1986, and for which such company is a passive foreign investment company, and

"(ii) which includes any portion of the taxpayer's holding period.

"(2) ELECTION TO RECOGNIZE GAIN WHERE COMPANY BECOMES QUALIFIED ELECTING FUND.—

"(A) IN GENERAL.—If—

"(i) a passive foreign investment company becomes a qualified electing fund for a taxable year which begins after December 31, 1986,

"(ii) the taxpayer holds stock in such company on the first day of such taxable year, and

"(iii) the taxpayer establishes to the satisfaction of the Secretary the fair market value of such stock on such first day,

the taxpayer may elect to recognize gain as if he sold such stock on such first day for such fair market value.

"(B) ADJUSTMENTS.—In the case of any stock to which subparagraph (A) applies—

"(i) the adjusted basis of such stock shall be increased by the gain recognized under subparagraph (A), and

"(ii) the taxpayer's holding period in such stock shall be treated as beginning on the first day referred to in subparagraph (A).

"(e) CERTAIN BASIS, ETC., RULES MADE APPLICABLE.—Rules similar to the rules of subsections (c), (d), (e), and (f) of section 1246 shall apply for purposes of this section; except that—

"(1) the reduction under subsection (e) of such section shall be the excess of the basis determined under section 1014 over the adjusted basis of the stock immediately before the decedent's death, and

"(2) such a reduction shall not apply in the case of a decedent who was not a nonresident alien at all times during his holding period in the stock.

"(f) NONRECOGNITION PROVISIONS.—To the extent provided in regulations, gain shall be recognized on any disposition of stock in a passive foreign investment company.

"Subpart B—Treatment of Qualified Electing Funds

"Sec. 1293. Current taxation of income from qualified electing funds.
"Sec. 1294. Election to extend time for payment of tax on undistributed earnings.
"Sec. 1295. Qualified electing fund.

"SEC. 1293. CURRENT TAXATION OF INCOME FROM QUALIFIED ELECTING FUNDS.

"(a) INCLUSION.—

"(1) IN GENERAL.—Every United States person who owns (or is treated under section 1297(a) as owning) stock of a qualified electing fund at any time during the taxable year of such fund shall include in gross income—

"(A) as ordinary income, such shareholder's pro rata share of the ordinary earnings of such fund for such year, and

"(B) as long-term capital gain, such shareholder's pro rata share of the net capital gain of such fund for such year.

"(2) YEAR OF INCLUSION.—The inclusion under paragraph (1) shall be for the taxable year of the shareholder in which or with which the taxable year of the fund ends.

"(b) PRO RATA SHARE.—The pro rata share referred to in subsection (a) in the case of any shareholder is the amount which would have been distributed with respect to the shareholder's stock if, on each day during the taxable year of the fund, the fund had distributed to each shareholder a pro rata share of that day's ratable share of the fund's ordinary earnings and net capital gain for such year.

"(c) PREVIOUSLY TAXED AMOUNTS DISTRIBUTED TAX FREE.—If the taxpayer establishes to the satisfaction of the Secretary that any amount distributed by a passive foreign investment company is paid out of earnings and profits of the company which were included under subsection (a) in the income of any United States person, such amount shall be treated as a distribution which is not a dividend.

"(d) BASIS ADJUSTMENTS.—The basis of the taxpayer's stock in a passive foreign investment company shall be—

"(1) increased by any amount which is included in the income of the taxpayer under subsection (a) with respect to such stock, and

"(2) decreased by any amount distributed with respect to such stock which is not includible in the income of the taxpayer by reason of subsection (c).

A similar rule shall apply also in the case of any property if by reason of holding such property the taxpayer is treated under section 1297(a) as owning stock in a qualified electing fund.

"(e) ORDINARY EARNINGS.—For purposes of this section—

"(1) ORDINARY EARNINGS.—The term 'ordinary earnings' means the excess of the earnings and profits of the qualified electing fund for the taxable year over its net capital gain for such taxable year.

"(2) LIMITATION ON NET CAPITAL GAIN.—A qualified electing fund's net capital gain for any taxable year shall not exceed its earnings and profits for such taxable year.

"(f) FOREIGN TAX CREDIT ALLOWED IN THE CASE OF 10-PERCENT CORPORATE SHAREHOLDER.—For purposes of section 960—

"(1) any amount included in the gross income under subsection (a) shall be treated as if it were included under section 951(a), and

"(2) any amount excluded from gross income under subsection (c) shall be treated in the same manner as amounts excluded from gross income under section 959.

"SEC. 1294. ELECTION TO EXTEND TIME FOR PAYMENT OF TAX ON UNDISTRIBUTED EARNINGS.

"(a) EXTENSION ALLOWED BY ELECTION.—

"(1) In general.—At the election of the taxpayer, the time for payment of any undistributed PFIC earnings tax liability of the taxpayer for the taxable year shall be extended to the extent and subject to the limitations provided in this section.

"(2) Election not permitted where amounts otherwise includible under section 551 or 951.—The taxpayer may not make an election under paragraph (1) with respect to the undistributed PFIC earnings tax liability attributable to a qualified electing fund for the taxable year if—

"(A) any amount is includible in the gross income of the taxpayer under section 551 with respect to such fund for such taxable year, or

"(B) any amount is includible in the gross income of the taxpayer under section 951 with respect to such fund for such taxable year.

"(b) Definitions.—For purposes of this section—

"(1) Undistributed PFIC earnings tax liability.—The term 'undistributed PFIC earnings tax liability' means, in the case of any taxpayer, the excess of—

"(A) the tax imposed by this chapter for the taxable year, over

"(B) the tax which would be imposed by this chapter for such year without regard to the inclusion in gross income under section 1293 of the undistributed earnings of a qualified electing fund.

"(2) Undistributed earnings.—The term 'undistributed earnings' means, with respect to any qualified electing fund, the excess (if any) of—

"(A) the amount includible in gross income by reason of section 1293(a) for the taxable year, over

"(B) the amount not includible in gross income by reason of section 1293(c) for such taxable year.

"(c) Termination of Extension.—

"(1) Distributions.—

"(A) In general.—If a distribution is not includible in gross income for the taxable year by reason of section 1293(c), then the extension under subsection (a) for payment of the undistributed PFIC earnings tax liability with respect to the earnings to which such distribution is attributable shall expire on the last date prescribed by law (determined without regard to extensions) for filing the return of tax for such taxable year.

"(B) Ordering rule.—For purposes of subparagraph (A), a distribution shall be treated as made from the most recently accumulated earnings and profits.

"(2) Disposition, etc.—If—

"(A) stock in a passive foreign investment company is disposed of during the taxable year, or

"(B) a passive foreign investment company ceases to be a qualified electing fund,

all extensions under subsection (a) for payment of undistributed PFIC earnings tax liability attributable to such stock (or, in the case of such a cessation, attributable to any stock in such company) which had not expired before the date of such disposition *or cessation shall expire on the last date prescribed by law (determined without regard to extensions) for filing the return of tax for the taxable year in which such disposition or cessation occurs.*

"(3) JEOPARDY.—If the Secretary believes that collection of an amount to which an extension under this section relates is in jeopardy, the Secretary shall immediately terminate such extension with respect to such amount, and notice and demand shall be made by him for payment of such amount.

"(d) ELECTION.—The election under subsection (a) shall be made not later than the time prescribed by law (including extensions) for filing the return of tax imposed by this chapter for the taxable year.

"(e) AUTHORITY TO REQUIRE BOND.—Section 6165 shall apply to any extension under this section as though the Secretary were extending the time for payment of the tax.

"SEC. 1295. QUALIFIED ELECTING FUND.

"(a) GENERAL RULE.—For purposes of this part, the term 'qualified electing fund' means any passive foreign investment company if—

"(1) an election under subsection (b) applies to such company for the taxable year, and

"(2) such company complies for such taxable year with such requirements as the Secretary may prescribe for purposes of—

"(A) determining the ordinary earnings and net capital gain of such company for the taxable year,

"(B) ascertaining the ownership of its outstanding stock, and

"(C) otherwise carrying out the purposes of this subpart.

"(b) ELECTION.—

"(1) IN GENERAL.—A passive foreign investment company may make an election under this subsection for any taxable year. Such an election, once made, shall apply to all subsequent taxable years of such company for which such company is a passive foreign investment company unless revoked with the consent of the Secretary.

"(2) WHEN MADE.—An election under this subsection may be made for any taxable year at any time before the 15th day of the 3rd month of the following taxable year.

"Subpart C—General Provisions

"Sec. 1296. Passive foreign investment company.
"Sec. 1297. Special rules.

"SEC. 1296. PASSIVE FOREIGN INVESTMENT COMPANY.

"(a) IN GENERAL.—For purposes of this part, except as otherwise provided in this subpart the term 'passive foreign investment company' means any foreign corporation if—

"(1) 75 percent or more of the gross income of such corporation for the taxable year is passive income, or

"(2) the average percentage of assets (by value) held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent.

"(b) PASSIVE INCOME.—For purposes of this section—

"(1) In general.—Except as provided in paragraph (2), the term 'passive income' has the meaning given such term by section 904(d)(2)(A) without regard to the exceptions contained in clause (iii) thereof.

"(2) Exception for certain banks and insurance companies.—Except as provided in regulations, the term 'passive income' does not include any income—

"(A) derived in the active conduct of a banking business by an institution licensed to do business as a bank in the United States (or, to the extent provided in regulations, by any other corporation), or

"(B) derived in the active conduct of an insurance business by a corporation which would be subject to tax under subchapter L if it were a domestic corporation.

"(c) Look-Thru in the Case of 25-Percent Owned Corporations.—If a foreign corporation owns at least 25 percent (by value) of the stock of another corporation, for purposes of determining whether such foreign corporation is a passive foreign investment company, such foreign corporation shall be treated as if it—

"(1) held its proportionate share of the assets of such other corporation, and

"(2) received directly its proportionate share of the income of such other corporation.

"(d) Section 1247 Corporations.—For purposes of this part, the term 'passive foreign investment company' does not include any foreign investment company to which section 1247 applies.

"SEC. 1297. SPECIAL RULES.

"(a) Attribution of Ownership.—For purposes of this part—

"(1) Attribution to united states persons.—This subsection—

"(A) shall apply to the extent that the effect is to treat stock of a passive foreign investment company as owned by a United States person, and

"(B) except to the extent provided in regulations, shall not apply to treat stock owned (or treated as owned under this subsection) by a United States person as owned by any other person.

"(2) Corporations.—

"(A) In general.—If 50 percent or more in value of the stock of a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned directly or indirectly by or for such corporation in that proportion which the value of the stock which such person so owns bears to the value of all stock in the corporation.

"(B) 50-percent limitation not to apply to PFIC.—For purposes of determining whether a shareholder of a passive foreign investment company is treated as owning stock owned directly or indirectly by or for such company, subparagraph (A) shall be applied without regard to the 50-percent limitation contained therein.

"(3) Partnerships, etc.—Stock owned, directly or indirectly, by or for a partnership, estate, or trust shall be considered as being owned proportionately by its partners or beneficiaries.

"(4) Successive application.—Stock considered to be owned by a person by reason of the application of paragraph (2) or (3) shall, for purposes of applying such paragraphs, be considered as actually owned by such person.

"(b) Other Special Rules.—For purposes of this part—

"(1) Time for determination.—Stock held by a taxpayer shall be treated as stock in a passive foreign investment company if, at any time during the holding period of the taxpayer with respect to such stock, such corporation (or any predecessor) was a passive foreign investment corporation which was not a qualified electing fund. The preceding sentence shall not apply if the taxpayer elects to recognize gain (as of the last day of the last taxable year for which the company was a passive foreign investment company) under rules similar to the rules of section 1291(d)(2).

"(2) Certain corporations not treated as PFIC's during start-up year.—A corporation shall not be treated as a passive foreign investment company for the first taxable year such corporation has gross income (hereinafter in this paragraph referred to as the 'start-up year') if—

"(A) no predecessor of such corporation was a passive foreign investment company,

"(B) it is established to the satisfaction of the Secretary that such corporation will not be a passive foreign investment company for either of the 1st 2 taxable years following the start-up year, and

"(C) such corporation is not a passive foreign investment company for either of the 1st 2 taxable years following the start-up year.

"(3) Certain corporations changing businesses.—A corporation shall not be treated as a passive foreign investment company for any taxable year if—

"(A) such corporation (and any predecessor) was not a passive foreign investment corporation for any prior taxable year,

"(B) it is established to the satisfaction of the Secretary that—

"(i) substantially all of the passive income of the corporation for the taxable year is attributable to proceeds from the disposition of 1 or more active trades or businesses, and

"(ii) such corporation will not be a passive foreign investment company for either of the 1st 2 taxable years following such taxable year, and

"(C) such corporation is not a passive foreign investment company for either of such 2 taxable years.

"(4) Separate interests treated as separate corporations.—Under regulations prescribed by the Secretary, where necessary to carry out the purposes of this part, separate classes of stock (or other interests) in a corporation shall be treated as interests in separate corporations.

"(5) APPLICATION OF SECTION WHERE STOCK HELD BY OTHER ENTITY.—*Under regulations, in any case in which a United States person is treated as holding stock in a passive foreign investment company by reason of subsection (a), any disposition by the United States person or the person holding such stock which results in the United States person being treated as no longer holding such stock, shall be treated as a disposition by the United States person with respect to stock in the passive foreign investment company.*

"(6) DISPOSITIONS.—*If a taxpayer uses any stock in a passive foreign investment company as security for a loan, the taxpayer shall be treated as having disposed of such stock.*

"(7) COORDINATION WITH SECTION 1246.—*Section 1246 shall not apply to earnings and profits of any company for any taxable year beginning after December 31, 1986, if such company is a passive foreign investment company for such taxable year.*

"(c) REGULATIONS.—*The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this part."*

(b) COORDINATION OF SECTION 1246 WITH SECTION 1248.—*Section 1246 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:*

"(f) COORDINATION WITH SECTION 1248.—*This section shall not apply to any gain to the extent such gain is treated as ordinary income under section 1248 (determined without regard to section 1248(g)(3))."*

(c) COORDINATION WITH SUBPART F.—*Section 951 (relating to amounts included in gross income of United States shareholders) is amended by adding at the end thereof the following new subsection:*

"(f) COORDINATION WITH PASSIVE FOREIGN INVESTMENT COMPANY PROVISIONS.—*If, but for this subsection, an amount would be included in the gross income of a United States shareholder for any taxable year both under subsection (a)(1)(A)(i) and under section 1293 (relating to current taxation of income from certain passive foreign investment companies), such amount shall be included in the gross income of such shareholder only under subsection (a)(1)(A)."*

(d) EXTENSION OF STATUTE OF LIMITATION.—*Section 6503 (relating to suspension of running of period of limitation) is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:*

"(j) EXTENSION OF TIME FOR PAYMENT OF UNDISTRIBUTED PFIC EARNINGS TAX LIABILITY.—*The running of any period of limitations for collection of any amount of undistributed PFIC earnings tax liability (as defined in section 1294(b)) shall be suspended for the period of any extension of time under section 1294 for payment of such amount."*

(e) COORDINATION WITH FOREIGN PERSONAL HOLDING COMPANY PROVISIONS.—*Section 551 is amended by redesignating subsection (g) as subsection (h) and by inserting after subsection (f) the following new subsection:*

"(g) COORDINATION WITH PASSIVE FOREIGN INVESTMENT COMPANY PROVISIONS.—*If, but for this subsection, an amount would be included in the gross income of any person under subsection (a) and under section 1293 (relating to current taxation of income from cer-*

tain passive foreign investment companies), such amount shall be included in the gross income of such person only under subsection (a).”

(f) OTHER TECHNICAL AMENDMENTS.—

(1) Subsection (b) of section 532 (relating to exceptions from accumulated earnings tax) is amended by striking out “or” at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof “, or”, and by adding at the end thereof the following new paragraph:

“(4) a passive foreign investment company (as defined in section 1296).”

(2) Subsection (c) of section 542 (relating to exceptions from personal holding company provisions) is amended by striking out “and” at the end of paragraph (8), by striking out the period at the end of paragraph (9) and inserting in lieu thereof “; and”, and by adding at the end thereof the following new paragraph:

“(10) a passive foreign investment company (as defined in section 1296).”

(3) The second sentence of section 851(b) is amended—

(A) by striking out “section 951(a)(1)(A)(i)” and inserting in lieu thereof “section 951(a)(1)(A)(i) or 1293(a)”, and

(B) by striking out “section 959(a)(1)” and inserting in lieu thereof “section 959(a)(1) or 1293(c) (as the case may be)”.

(4)(A) Subparagraph (A) of section 904(g)(1) is amended by striking out “or” at the end of clause (i), by striking out the period at the end of clause (ii) and inserting in lieu thereof “, or”, and by adding at the end thereof the following new clause:

“(iii) section 1293 (relating to current taxation of income from qualified funds).”

(B) The paragraph heading of section 904(g)(2) is amended by striking out “HOLDING COMPANY” and inserting in lieu thereof “HOLDING OR PASSIVE FOREIGN INVESTMENT COMPANY”.

(g) CLERICAL AMENDMENT.—The table of parts for subchapter P of chapter 1 is amended by adding at the end thereof the following new item:

“Part VI. Treatment of certain passive foreign investment companies.”

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years of foreign corporations beginning after December 31, 1986.

SEC. 1236. TREATMENT OF INTEREST ON OBLIGATIONS OF THE UNITED STATES RECEIVED BY BANKS ORGANIZED IN GUAM.

(a) IN GENERAL.—Subsection (e) of section 882 (relating to interest on United States obligations received by banks organized in possessions) is amended by adding at the end thereof the following sentence:

“The preceding sentence shall not apply to any Guam corporation which is treated as not being a foreign corporation by section 881(b)(1) for the taxable year.”

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after November 16, 1985.

Subtitle E—Treatment of Foreign Taxpayers

SEC. 1241. BRANCH PROFITS TAX.

(a) GENERAL RULE.—Subpart B of part II of subchapter N of chapter 1 (relating to foreign corporations) is amended by redesignating section 884 as section 885 and by inserting after section 883 the following new section:

"SEC. 884. BRANCH PROFITS TAX.

"(a) IMPOSITION OF TAX.—In addition to the tax imposed by section 882 for any taxable year, there is hereby imposed on any foreign corporation a tax equal to 30 percent of the dividend equivalent amount for the taxable year.

"(b) DIVIDEND EQUIVALENT AMOUNT.—For purposes of subsection (a), the term 'dividend equivalent amount' means the foreign corporation's effectively connected earnings and profits for the taxable year adjusted as provided in this subsection:

"(1) REDUCTION FOR INCREASE IN U.S. NET EQUITY.—If—

"(A) the U.S. net equity of the foreign corporation as of the close of the taxable year, exceeds

"(B) the U.S. net equity of the foreign corporation as of the close of the preceding taxable year,

the effectively connected earnings and profits for the taxable year shall be reduced (but not below zero) by the amount of such excess.

"(2) INCREASE FOR DECREASE IN NET EQUITY.—

"(A) IN GENERAL.—If—

"(i) the U.S. net equity of the foreign corporation as of the close of the preceding taxable year, exceeds

"(ii) the U.S. net equity of the foreign corporation as of the close of the taxable year,

the effectively connected earnings and profits for the taxable year shall be increased by the amount of such excess.

"(B) LIMITATION.—The increase under subparagraph (A) for any taxable year shall not exceed the aggregate reductions under paragraph (1) for prior taxable years to the extent not previously taken into account under subparagraph (A).

"(c) U.S. NET EQUITY.—For purposes of this section—

"(1) IN GENERAL.—The term 'U.S. net equity' means—

"(A) U.S. assets, reduced (including below zero) by

"(B) U.S. liabilities.

"(2) U.S. ASSETS AND U.S. LIABILITIES.—For purposes of paragraph (1)—

"(A) U.S. ASSETS.—The term 'U.S. assets' means the money and aggregate adjusted bases of property of the foreign corporation treated as connected with the conduct of a trade or business in the United States under regulations prescribed by the Secretary. For purposes of the preceding sentence, the adjusted basis of any property shall be its adjusted basis for purposes of computing earnings and profits.

"(B) U.S. LIABILITIES.—The term 'U.S. liabilities' means the liabilities of the foreign corporation treated as connect-

ed with the conduct of a trade or business in the United States under regulations prescribed by the Secretary.

"(C) Regulations to be consistent with allocation of deductions.—The regulations prescribed under subparagraphs (A) and (B) shall be consistent with the allocation of deductions under section 882(c)(1).

"(d) Effectively Connected Earnings and Profits.—For purposes of this section—

"(1) In general.—The term 'effectively connected earnings and profits' means earnings and profits (without diminution by reason of any distributions made during the taxable year) which are attributable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.

"(2) Exception for certain income.—The term 'effectively connected earnings and profits' shall not include any earnings and profits attributable to—

"(A) income not includible in gross income under paragraph (1) or (2) of section 883(a),

"(B) income treated as effectively connected with the conduct of a trade or business within the United States under section 921(d) or 926(b),

"(C) gain on the disposition of a United States real property interest described in section 897(c)(1)(A)(ii), or

"(D) income treated as effectively connected with the conduct of a trade or business within the United States under section 953(c)(3)(C).

Property and liabilities of the foreign corporation treated as connected with such income under regulations prescribed by the Secretary shall not be taken into account in determining the U.S. assets or U.S. liabilities of the foreign corporation.

"(e) Coordination With Income Tax Treaties; Etc.—

"(1) Limitation on treaty exemption.—No income tax treaty between the United States and a foreign country shall exempt any foreign corporation from the tax imposed by subsection (a) (or reduce the amount thereof) unless—

"(A) such foreign corporation is a qualified resident of such foreign country, or

"(B) such foreign corporation is not a qualified resident of such foreign country but such income tax treaty permits a withholding tax on dividends described in section 861(a)(2)(B) which are paid by such foreign corporation.

"(2) Treaty modifications.—If a foreign corporation is a qualified resident of a foreign country with which the United States has an income tax treaty—

"(A) the rate of tax under subsection (a) shall be the rate of tax specified in such treaty—

"(i) on branch profits if so specified, or

"(ii) if not so specified, on dividends paid by a domestic corporation to a corporation resident in such country which wholly owns such domestic corporation, and

"(B) any other limitations under such treaty on the tax imposed by subsection (a) shall apply.

"(3) COORDINATION WITH 2ND TIER WITHHOLDING TAX.—

"(A) IN GENERAL.—If a foreign corporation is not exempt for any taxable year from the tax imposed by subsection (a) by reason of a treaty, no tax shall be imposed by section 871(a), 881(a), 1441, or 1442 on any dividends paid by such corporation during the taxable year.

"(B) LIMITATION ON CERTAIN TREATY BENEFITS.—No foreign corporation which is not a qualified resident of a foreign country shall be entitled to claim benefits under any income tax treaty between the United States and such foreign country with respect to dividends—

"(i) which are paid by such foreign corporation and with respect to which such foreign corporation is otherwise required to deduct and withhold tax under section 1441 or 1442, or

"(ii) which are received by such foreign corporation and are described in section 861(a)(2)(B).

"(4) QUALIFIED RESIDENT.—For purposes of this subsection—

"(A) IN GENERAL.—Except as otherwise provided in this paragraph, the term 'qualified resident' means, with respect to any foreign country, any foreign corporation which is a resident of such foreign country unless—

"(i) more than 50 percent (by value) of the stock of such foreign corporation is owned (within the meaning of section 883(c)(4)) by individuals who are not residents of such foreign country and who are not United States citizens or resident aliens, or

"(ii) 50 percent or more of its income is used (directly or indirectly) to meet liabilities to persons who are not residents of such foreign country or the United States.

"(B) SPECIAL RULE FOR PUBLICLY TRADED CORPORATIONS.—A foreign corporation which is a resident of a foreign country shall be treated as a qualified resident of such foreign country if—

"(i) the stock of such corporation is primarily and regularly traded on an established securities market in such foreign country, or

"(ii) such corporation is wholly owned (either directly or indirectly) by another foreign corporation which is organized in such foreign country and the stock of which is so traded.

"(C) SECRETARIAL AUTHORITY.—The Secretary may, in his sole discretion, treat a foreign corporation as being a qualified resident of a foreign country if such corporation establishes to the satisfaction of the Secretary that such corporation meets such requirements as the Secretary may establish to ensure that individuals who are not residents of such foreign country do not use the treaty between such foreign country and the United States in a manner inconsistent with the purposes of this subsection.

"(f) TREATMENT OF INTEREST ALLOCABLE TO EFFECTIVELY CONNECTED INCOME.—

"(1) In general.—In the case of a foreign corporation engaged in a trade or business in the United States, for purposes of sections 871, 881, 1441, and 1442—

"(A) any interest paid by such trade or business in the United States shall be treated as if it were paid by a domestic corporation, and

"(B) to the extent the amount of interest allowable as a deduction under section 882 in computing the effectively connected taxable income of such foreign corporation exceeds the interest described in subparagraph (A), such foreign corporation shall be liable for tax under section 881(a) in the same manner as if such excess were interest paid to such foreign corporation by a wholly owned domestic corporation on the last day of such foreign corporation's taxable year.

Rules similar to the rules of subsection (e)(3)(B) shall apply to interest described in the preceding sentence.

"(2) Effectively connected taxable income.—For purposes of this subsection, the term 'effectively connected taxable income' means taxable income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.

"(g) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including regulations providing for appropriate adjustments in the determination of the dividend equivalent amount in connection with the distribution to shareholders or transfer to a controlled corporation of the taxpayer's U.S. assets and other adjustments in such determination as are necessary or appropriate to carry out the purposes of this section."

(b) Amendments to Interest and Dividend Sourcing Rules.—

(1) Interest.—Paragraph (1) of section 861(a) (as amended by section 1214) is amended—

(A) by striking out "residents, corporate or otherwise," in the matter preceding subparagraph (A) and inserting in lieu thereof "noncorporate residents or domestic corporations", and

(B) by striking out subparagraphs (B) and (C) and by redesignating subparagraphs (D), (E), and (F) as subparagraphs (B), (C), and (D), respectively.

(2) Dividends.—Subparagraph (B) of section 861(a)(2) is amended—

(A) by striking out "50 percent" and inserting in lieu thereof "25 percent", and

(B) by striking out "effectively connected" each place it appears and inserting in lieu thereof "effectively connected (or treated as effectively connected other than under section 884(a)(2))".

(c) Disallowance of Credit.—Subsection (b) of section 906 is amended by adding at the end thereof the following new paragraph:

"(6) No credit shall be allowed under this section against the tax imposed by section 884."

(d) Clerical Amendment.—The table of sections for subpart B of part II of subchapter N of chapter 1 is amended by striking out the

item relating to section 884 and inserting in lieu thereof the following:

"Sec. 884. Branch profits tax.
"Sec. 885. Cross references."

(e) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1242. TREATMENT OF DEFERRED PAYMENTS AND APPRECIATION ARISING OUT OF BUSINESS CONDUCTED WITHIN THE UNITED STATES.

(a) General Rule.—Subsection (c) of section 864 (defining effectively connected income) is amended by adding at the end thereof the following new paragraphs:

"(6) Treatment of certain deferred payments, etc.—For purposes of this title, any income or gain of a nonresident alien individual or a foreign corporation for any taxable year which is attributable to a sale or exchange of property or the performance of services (or any other transaction) in any other taxable year shall be treated as effectively connected with the conduct of a trade or business within the United States if it would have been so treated if such income or gain were taken into account in such other taxable year.

"(7) Treatment of certain property transactions.—For purposes of this title, if any property ceases to be used or held for use in connection with the conduct of a trade or business within the United States, the determination of whether any income or gain attributable to a sale or exchange of such property occurring within 10 years after such cessation is effectively connected with the conduct of a trade or business within the United States shall be made as if such sale or exchange occurred immediately before such cessation."

(b) Conforming Amendments.—Paragraph (1) of section 864(c) is amended—

(1) by striking out "and (4)" in subparagraph (A) and inserting in lieu thereof "(4), (6), and (7)", and

(2) by striking out "as provided in" in subparagraph (B) and inserting in lieu thereof "as provided in paragraph (6) or (7) or in".

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1243. TREATMENT UNDER SECTION 877 OF PROPERTY RECEIVED IN TAX-FREE EXCHANGES, ETC.

(a) General Rule.—Subsection (c) of section 877 (relating to expatriation to avoid tax) is amended by adding at the end thereof the following new sentence:

"For purposes of this section, gain on the sale or exchange of property which has a basis determined in whole or in part by reference to property described in paragraph (1) or (2) shall be treated as gain described in paragraph (1) or (2)."

(b) Effective Date.—The amendment made by subsection (a) shall apply to sales or exchanges of property received in exchanges after September 25, 1985.

SEC. 1244. STUDY OF UNITED STATES REINSURANCE INDUSTRY.

The Secretary of the Treasury or his delegate shall conduct a study to determine whether United States reinsurance corporations are placed at a significant competitive disadvantage with foreign reinsurance corporations by existing treaties between the United States and foreign countries. The Secretary shall report before January 1, 1988, the results of such study to the Committee on Finance of the United States Senate and the Committee on Ways and Means of the House of Representatives.

SEC. 1245. INFORMATION WITH RESPECT TO CERTAIN FOREIGN-OWNED CORPORATIONS.

(a) In General.—Paragraph (1) of section 6038A(b) (relating to certain required information) is amended—

(1) by striking out "each corporation" in the matter preceding subparagraph (A) and inserting in lieu thereof "each person", and

(2) by striking out subparagraph (A) and inserting in lieu thereof the following:

"(A) is a related party to the reporting corporation, and".

(b) Conforming Amendments.—

(1) Paragraph (2) of section 6038A(b) is amended by striking out "each corporation" and inserting in lieu thereof "each person".

(2) Paragraph (3) of section 6038A(b) is amended to read as follows:

"(3) transactions between the reporting corporation and each foreign person which is a related party to the reporting corporation."

(3) Subsection (b) of section 6038A is amended by striking out "and" at the end of paragraph (2), by striking out the period at the end of paragraph (3) and inserting in lieu thereof ", and", and by adding at the end thereof the following new paragraph:

"(4) such information as the Secretary may require for purposes of carrying out the provisions of section 453C."

(4) Paragraph (2) of section 6038A(c) is amended to read as follows:

"(2) Related party.—The term 'related party' means—

"(A) any person who is related to the reporting corporation within the meaning of section 267(b) or 707(b)(1), and

"(B) any other person who is related (within the meaning of section 482) to the reporting corporation."

(5) Paragraph (1) of section 6038(a) is amended by striking out "and" at the end of subparagraph (D), by striking out the period at the end of subparagraph (E) and inserting in lieu thereof ", and", and by inserting after subparagraph (E) the following new subparagraph:

"(F) such information as the Secretary may require for purposes of carrying out the provisions of section 453C."

(c) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1246. WITHHOLDING TAX ON AMOUNTS PAID BY PARTNERSHIPS TO FOREIGN PARTNERS.

(a) IN GENERAL.—Subchapter A of chapter 3 (relating to withholding of tax on nonresident) is amended by adding at the end thereof the following new section:

"SEC. 1446. WITHHOLDING TAX ON AMOUNTS PAID BY PARTNERSHIPS TO FOREIGN PARTNERS.

"(a) GENERAL RULE.—Except as provided in this section, if a partnership has any income, gain, or loss which is effectively connected or treated as effectively connected with the conduct of a trade or business within the United States, any person described in section 1441(a) shall be required to deduct and withhold a tax equal to 20 percent of any amount distributed to a partner which is not a United States person.

"(b) LIMITATION IF LESS THAN 80 PERCENT OF GROSS INCOME IS EFFECTIVELY CONNECTED WITH UNITED STATES TRADE OR BUSINESS.—

"(1) IN GENERAL.—If the effectively connected percentage is less than 80 percent, only the effectively connected percentage of any distribution shall be taken into account under subsection (a).

"(2) EFFECTIVELY CONNECTED PERCENTAGE.—For purposes of paragraph (1) the term 'effectively connected percentage' means the percentage of the gross income of the partnership for the 3 taxable years preceding the taxable year of the distribution which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.

"(c) EXCEPTIONS.—

"(1) AMOUNTS ON WHICH TAX WITHHELD.—Subsection (a) shall not apply to that portion of any distribution with respect to which a tax is required to be deducted and withheld under section 1441 or 1442 (or would be required to be deducted and withheld but for a treaty).

"(2) PARTNERSHIPS WITH CERTAIN ALLOCATIONS.—Except as provided in regulations, subsection (a) shall not apply to any partnership with respect to which substantially all income from sources within the United States and substantially all income which is effectively connected with the conduct of a trade or business within the United States is properly allocated to United States persons.

"(3) COORDINATION WITH SECTION 1445.—Under regulations proper adjustments shall be made in the amount required to be deducted and withheld under subsection (a) for amounts deducted and withheld under section 1445.

"(d) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section."

(b) COORDINATION WITH SECTION 6401(b).—Paragraph (2) of section 6401(b) (relating to excessive credits treated as overpayments) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to any amount deducted and withheld under section 1446."

(c) Conforming Amendment.—The table of sections for subchapter A of chapter 3 is amended by adding at the end thereof the following new item:

"Sec. 1446. Withholding tax on amounts paid by partnerships to foreign partners."

(d) Effective Date.—The amendment made by this section shall apply to distributions after December 31, 1987, (or, if earlier, the effective date (which shall not be earlier than January 1, 1987) of the initial regulations issued under section 1446 of the Internal Revenue Code of 1986 as added by this section).

SEC. 1247. INCOME OF FOREIGN GOVERNMENTS.

(a) Special Rule.—Section 892 (relating to income of foreign governments and of international organizations) is amended to read as follows:

"SEC. 892. INCOME OF FOREIGN GOVERNMENTS AND OF INTERNATIONAL ORGANIZATIONS.

"(a) Foreign Governments.—

"(1) In general.—The income of foreign governments received from—

"(A) investments in the United States in—

"(i) stock, bonds, or other domestic securities owned by such foreign governments, or

"(ii) financial instruments held in the execution of governmental financial or monetary policy, or

"(B) interest on deposits in banks in the United States of moneys belonging to such foreign governments,

shall not be included in gross income and shall be exempt from taxation under this subtitle.

"(2) Income received directly or indirectly from commercial activities.—

"(A) In general.—Paragraph (1) shall not apply to any income—

"(i) derived from the conduct of any commercial activity (whether within or outside the United States), or

"(ii) received from or by a controlled commercial entity.

"(B) Controlled commercial entity.—For purposes of subparagraph (A), the term 'controlled commercial entity' means any entity engaged in commercial activities (whether within or outside the United States) if the government—

"(i) holds (directly or indirectly) any interest in such entity which (by value or voting interest) is 50 percent or more of the total of such interests in such entity, or

"(ii) holds (directly or indirectly) any other interest in such entity which provides the foreign government with effective control of such entity.

For purposes of the preceding sentence, a central bank of issue shall be treated as a controlled commercial entity only if engaged in commercial activities within the United States.

"(b) International Organizations.—The income of international organizations received from investments in the United States in stocks, bonds, or other domestic securities owned by such international organizations, or from interest on deposits in banks in the

United States of moneys belonging to such international organizations, or from any other source within the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

"(c) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section."

(b) Effective Date.—The amendment made by subsection (a) shall apply to amounts received on or after July 1, 1986, except that no amount shall be required to be deducted and withheld by reason of the amendment made by subsection (a) from any payment made before the date of the enactment of this Act.

SEC. 1248. LIMITATION ON COST OF PROPERTY IMPORTED FROM RELATED PERSONS.

(a) In General.—Part IV of subchapter O of chapter 1 (relating to special rules for determination of basis) is amended by inserting after section 1059 the following new section:

"SEC. 1059A. LIMITATION ON TAXPAYER'S BASIS OR INVENTORY COST IN PROPERTY IMPORTED FROM RELATED PERSONS.

"(a) In General.—If any property is imported into the United States in a transaction (directly or indirectly) between related persons (within the meaning of section 482), the amount of any costs—

"(1) which are taken into account in computing the basis or inventory cost of such property by the purchaser, and

"(2) which are also taken into account in computing the customs value of such property,

shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.

"(b) Customs Value; Import.—For purposes of this section—

"(1) Customs value.—The term 'customs value' means the value taken into account for purposes of determining the amount of any customs duties or any other duties which may be imposed on the importation of any property.

"(2) Import.—Except as provided in regulations, the term 'import' means the entering, or withdrawal from warehouse, for consumption."

(b) Conforming Amendment.—The table of sections for part IV of subchapter O of chapter 1 is amended by inserting after the item relating to section 1059 and inserting in lieu thereof the following new item:

"Sec. 1059A. Limitation on taxpayer's basis or inventory cost in property imported from related persons."

(c) Effective Date.—The amendments made by this section shall apply to transactions entered into after March 18, 1986.

SEC. 1249. TREATMENT OF DUAL RESIDENCE CORPORATIONS.

(a) General Rule.—Section 1503 (relating to consolidated return) is amended by adding at the end thereof the following new subsection:

"(d) Dual Consolidated Loss.—

"(1) In general.—The dual consolidated loss for any taxable year of any corporation shall not be allowed to reduce the tax-

able income of any other member of the affiliated group for the taxable year or any other taxable year.

"(2) Dual consolidated loss.—For purposes of this section—

"(A) In general.—Except as provided in subparagraph (B), the term 'dual consolidated loss' means any net operating loss of a domestic corporation which is subject to an income tax of a foreign country on its income without regard to whether such income is from sources in or outside of such foreign country, or is subject to such a tax on a residence basis.

"(B) Special rule where loss not used under foreign law.—To the extent provided in regulations, the term 'dual consolidated loss' shall not include any loss which, under the foreign income tax law, does not offset the income of any foreign corporation."

(b) Effective Date.—The amendment made by subsection (a) shall apply to net operating losses for taxable years beginning after December 31, 1986.

Subtitle F—Foreign Currency Transactions

SEC. 1261. TREATMENT OF FOREIGN CURRENCY TRANSACTIONS.

(a) General Rule.—Part III of subchapter N of chapter 1 is amended by adding at the end thereof the following new subpart:

"Subpart J—Foreign Currency Transactions

"Sec. 985. Functional currency.
"Sec. 986. Determination of foreign corporation's earnings and profits and foreign taxes.
"Sec. 987. Branch transactions.
"Sec. 988. Treatment of certain foreign currency transactions.
"Sec. 989. Other definitions and special rules.

"SEC. 985. FUNCTIONAL CURRENCY.

"(a) In General.—Unless otherwise provided in regulations, all determinations under this subtitle shall be made in the taxpayer's functional currency.

"(b) Functional Currency.—

"(1) In general.—For purposes of this subtitle, the term 'functional currency' means—

"(A) except as provided in subparagraph (B), the dollar, or

"(B) in the case of a qualified business unit, the currency of the economic environment in which a significant part of such unit's activities are conducted and which is used by such unit in keeping its books and records.

"(2) Functional currency where activities primarily conducted in dollars.—The functional currency of any qualified business unit shall be the dollar if activities of such unit are primarily conducted in dollars.

"(3) Election.—To the extent provided in regulations, the taxpayer may elect to use the dollar as the functional currency for any qualified business unit if—

"(A) such unit keeps its books and records in dollars, or

"(B) the taxpayer uses a method of accounting that approximates a separate transactions method.

Any such election shall apply to the taxable year for which made and all subsequent taxable years unless revoked with the consent of the Secretary.

"(4) CHANGE IN FUNCTIONAL CURRENCY TREATED AS A CHANGE IN METHOD OF ACCOUNTING.—Any change in the functional currency shall be treated as a change in the taxpayer's method of accounting for purposes of section 481 under procedures to be established by the Secretary.

"SEC. 986. DETERMINATION OF FOREIGN CORPORATION'S EARNINGS AND PROFITS AND FOREIGN TAXES.

"(a) EARNINGS AND PROFITS AND DISTRIBUTIONS.—For purposes of determining the tax under this subtitle—

"(1) of any shareholder of any foreign corporation, the earnings and profits of such corporation shall be determined in the corporation's functional currency, and

"(2) in the case of any United States person, the earnings and profits determined under paragraph (1) (when distributed, deemed distributed, or otherwise taken into account under this subtitle) shall (if necessary) be translated into dollars using the appropriate exchange rate.

"(b) FOREIGN TAXES.—

"(1) IN GENERAL.—In determining the amount of foreign taxes deemed paid under section 902 or 960—

"(A) any foreign income taxes paid by a foreign corporation shall be translated into dollars using the exchange rates as of the time of payment, and

"(B) any adjustment to the amount of foreign income taxes paid by a foreign corporation shall be translated into dollars using—

"(i) except as provided in clause (ii), the appropriate exchange rate as of when such adjustment is made, and

"(ii) in the case of any refund or credit of foreign taxes, using the exchange rate as of the time of original payment of such foreign income taxes.

"(2) FOREIGN INCOME TAXES.—For purposes of paragraph (1), 'foreign income taxes' means any income, war profits, or excess profits taxes paid to any foreign country or to any possession of the United States.

"(c) PREVIOUSLY TAXED EARNINGS AND PROFITS.—

"(1) IN GENERAL.—Foreign currency gain or loss with respect to distributions of previously taxed earnings and profits (as described in section 959 or 1293(c)) attributable to movements in exchange rates between the times of deemed and actual distribution shall be recognized and treated as ordinary income or loss from the same source as the associated income inclusion.

"(2) DISTRIBUTIONS THROUGH TIERS.—The Secretary shall prescribe regulations with respect to the treatment of distributions of previously taxed earnings and profits through tiers of foreign corporations.

"SEC. 987. BRANCH TRANSACTIONS.

"In the case of any taxpayer having 1 or more qualified business units with a functional currency other than the dollar, taxable income of such taxpayer shall be determined—

"(1) by computing the taxable income or loss separately for each such unit in its functional currency,

"(2) by translating the income or loss separately computed under paragraph (1) at the appropriate exchange rate,

"(3) by making proper adjustments (as prescribed by the Secretary) for transfers of property between qualified business units of the taxpayer having different functional currencies, including—

"(A) treating post-1986 remittances from each such unit as made on a pro rata basis out of post-1986 accumulated earnings, and

"(B) treating gain or loss determined under this paragraph as ordinary income or loss, respectively, and sourcing such gain or loss by reference to the source of the income giving rise to post-1986 accumulated earnings, and

"(4) by translating foreign income taxes paid by each qualified business unit of the taxpayer in the same manner as provided under section 986(b).

"SEC. 988. TREATMENT OF CERTAIN FOREIGN CURRENCY TRANSACTIONS.

"(a) GENERAL RULE.—

"(1) TREATMENT AS ORDINARY INCOME OR LOSS.—

"(A) IN GENERAL.—Except as otherwise provided in this section, any foreign currency gain or loss attributable to a section 988 transaction shall be computed separately and treated as ordinary income or loss (as the case may be).

"(B) SPECIAL RULE FOR FORWARD CONTRACTS, ETC.—Except as provided in regulations, a taxpayer may elect to treat any foreign currency gain or loss attributable to a forward contract, a futures contract, or option described in subsection (c)(1)(B)(iii) which is a capital asset in the hands of the taxpayer and which is not a part of a straddle (within the meaning of section 1092(c), without regard to paragraph (4) thereof) as capital gain or loss (as the case may be) if the taxpayer makes such election and identifies such transaction before the close of the day on which such transaction is entered into (or such earlier time as the Secretary may prescribe).

"(2) GAIN OR LOSS TREATED AS INTEREST FOR CERTAIN PURPOSES.—To the extent provided in regulations, any amount treated as ordinary income or loss under paragraph (1) shall be treated as interest income or expense (as the case may be).

"(3) SOURCE.—

"(A) IN GENERAL.—Except as otherwise provided in regulations, in the case of any amount treated as ordinary income or loss under paragraph (1) (without regard to paragraph (1)(B)), the source of such amount shall be determined by reference to the residence of the taxpayer or the qualified business unit of the taxpayer on whose books the

asset, liability, or item of income or expense is properly reflected.

"(B) RESIDENCE.—For purposes of this subpart—

"(i) IN GENERAL.—The residence of any person shall be—

"(I) in the case of an individual, the country in which such individual's tax home (as defined in section 911(d)(3)) is located,

"(II) in the case of any corporation, partnership, trust, or estate which is a United States person (as defined in section 7701(a)(30)), the United States, and

"(III) in the case of any corporation, partnership, trust, or estate which is not a United States person, a country other than the United States.

"(ii) EXCEPTION.—In the case of a qualified business unit of any taxpayer (including an individual), the residence of such unit shall be the country in which the principal place of business of such qualified business unit is located.

"(C) SPECIAL RULE FOR CERTAIN RELATED PARTY LOANS.—Except to the extent provided in regulations, in the case of a loan by a United States person or a related person to a 10-percent owned foreign corporation which is denominated in a currency other than the dollar and bears interest at a rate at least 10 percentage points higher than the Federal mid-term rate (determined under section 1274(d)) at the time such loan is entered into, the following rules shall apply:

"(i) For purposes of section 904 only, such loan shall be marked to market on an annual basis.

"(ii) Any interest income earned with respect to such loan for the taxable year shall be treated as income from sources within the United States to the extent of any loss attributable to clause (i).

For purposes of this subparagraph, the term 'related person' has the meaning given such term by section 954(d)(3), except that such section shall be applied by substituting 'United States person' for 'controlled foreign corporation' each place such term appears.

"(D) 10-PERCENT OWNED FOREIGN CORPORATION.—The term '10-percent owned foreign corporation' means any foreign corporation in which the United States person owns directly or indirectly at least 10 percent of the voting stock.

"(b) FOREIGN CURRENCY GAIN OR LOSS.—For purposes of this section—

"(1) FOREIGN CURRENCY GAIN.—The term 'foreign currency gain' means any gain from a section 988 transaction to the extent such gain does not exceed gain realized by reason of changes in exchange rates on or after the booking date and before the payment date.

"(2) FOREIGN CURRENCY LOSS.—The term 'foreign currency loss' means any loss from a section 988 transaction to the extent such loss does not exceed the loss realized by reason of changes

in exchange rates on or after the booking date and before the payment date.

"(c) Other Definitions.—For purposes of this section—

"(1) Section 988 transaction.—

"(A) In general.—The term 'section 988 transaction' means any transaction described in subparagraph (B) if the amount which the taxpayer is entitled to receive (or is required to pay) by reason of such transaction—

"(i) is denominated in terms of a nonfunctional currency, or

"(ii) is determined by reference to the value of 1 or more nonfunctional currencies.

"(B) Description of transactions.—For purposes of subparagraph (A), the following transactions are described in this subparagraph:

"(i) The acquisition of a debt instrument or becoming the obligor under a debt instrument.

"(ii) Accruing (or otherwise taking into account) for purposes of this subtitle any item of expense or gross income or receipts which is to be paid or received after the date on which so accrued or taken into account.

"(iii) Entering into or acquiring any forward contract, futures contract, option, or similar financial instrument if such instrument is not marked to market at the close of the taxable year under section 1256.

The Secretary may prescribe regulations excluding from the application of clause (ii) any class of items the taking into account of which is not necessary to carry out the purposes of this section by reason of the small amounts or short periods involved, or otherwise.

"(C) Special rules for disposition of nonfunctional currency.—

"(i) In general.—In the case of any disposition of any nonfunctional currency—

"(I) such disposition shall be treated as a section 988 transaction, and

"(II) for purposes of determining the foreign currency gain or loss from such transaction, paragraphs (1) and (2) of subsection (b) shall be applied by substituting 'acquisition date' for 'booking date' and 'disposition' for 'payment date'.

"(ii) Nonfunctional currency.—For purposes of this section, the term 'nonfunctional currency' includes coin or currency, and nonfunctional currency denominated demand or time deposits or similar instruments issued by a bank or other financial institution.

"(2) Booking date.—The term 'booking date' means—

"(A) in the case of a transaction described in paragraph (1)(B)(i), the date of acquisition or on which the taxpayer becomes the obligor,

"(B) in the case of a transaction described in paragraph (1)(B)(ii), the date on which accrued or otherwise taken into account, or

"(C) in the case of a transaction described in paragraph (1)(B)(iii), the date on which the position is entered into or acquired.

"(3) PAYMENT DATE.—The term 'payment date' means—

"(A) in the case of a transaction described in paragraph (1)(B) (i) or (ii), the date on which payment is made or received, or

"(B) in the case of a transaction described in paragraph (1)(B)(iii), the date payment is made or received or the date the taxpayer's rights with respect to the position are terminated.

"(4) DEBT INSTRUMENT.—The term 'debt instrument' means a bond, debenture, note, or certificate or other evidence of indebtedness. To the extent provided in regulations, such term shall include preferred stock.

"(d) TREATMENT OF 988 HEDGING TRANSACTIONS.—

"(1) IN GENERAL.—To the extent provided in regulations, if any section 988 transaction is part of a 988 hedging transaction, all transactions which are part of such 988 hedging transaction shall be integrated and treated as a single transaction or otherwise treated consistently for purposes of this section. For purposes of the preceding sentence, the determination of whether any transaction is a section 988 transaction shall be determined without regard to whether such transaction would otherwise be marked-to-market under section 1256 and such term shall not include any transaction with respect to which an election is made under subsection (a)(1)(B). Sections 1092 and 1256 shall not apply to a transaction covered by this subsection.

"(2) 988 HEDGING TRANSACTION.—For purposes of paragraph (1), the term '988 hedging transaction' means any transaction—

"(A) entered into by the taxpayer primarily—

"(i) to reduce risk of currency fluctuations with respect to property which is held or to be held by the taxpayer, or

"(ii) to reduce risk of currency fluctuations with respect to borrowings made or to be made, or obligations incurred or to be incurred, by the taxpayer, and

"(B) identified by the Secretary or the taxpayer as being a 988 hedging transaction.

"(e) APPLICATION TO INDIVIDUALS.—This section shall apply to section 988 transactions entered into by an individual only to the extent expenses properly allocable to such transactions meet the requirements of section 162 or 212 (other than that part of section 212 dealing with expenses incurred in connection with taxes).

"SEC. 989. OTHER DEFINITIONS AND SPECIAL RULES.

"(a) QUALIFIED BUSINESS UNIT.—For purposes of this subpart, the term 'qualified business unit' means any separate and clearly identified unit of a trade or business of a taxpayer which maintains separate books and records.

"(b) APPROPRIATE EXCHANGE RATE.—Except as provided in regulations, for purposes of this subpart, the term 'appropriate exchange rate' means—

"(1) in the case of an actual distribution of earnings and profits, the spot rate on the date such distribution is included in income,

"(2) in the case of an actual or deemed sale or exchange of stock in a foreign corporation treated as a dividend under section 1248, the spot rate on the date the deemed dividend is included in income,

"(3) in the case of any amounts included in income under section 951(a), 551(a), or 1293(a), the weighted average exchange rate for the taxable year of the foreign corporation, or

"(4) in the case of any other qualified business unit of a taxpayer, the weighted average exchange rate for the taxable year of such qualified business unit.

"(c) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subpart, including regulations—

"(1) setting forth procedures to be followed by taxpayers with qualified business units using a net worth method of accounting before the enactment of this subpart,

"(2) limiting the recognition of foreign currency loss on certain remittances from qualified business units,

"(3) providing for the recharacterization of interest and principal payments with respect to obligations denominated in certain hyperinflationary currencies,

"(4) providing for alternative adjustments to the application of section 905(c), and

"(5) providing for the appropriate treatment of related party transactions (including transactions between qualified business units of the same taxpayer)."

(b) APPLICATION OF SECTION 1092 TO FOREIGN CURRENCY.—Section 1092(d) is amended by adding at the end thereof the following new paragraph:

"(7) SPECIAL RULES FOR FOREIGN CURRENCY.—

"(A) POSITION TO INCLUDE INTEREST IN CERTAIN DEBT.—For purposes of paragraph (2), an obligor's interest in a nonfunctional currency denominated debt obligation is treated as a position in the nonfunctional currency.

"(B) ACTIVELY TRADED REQUIREMENT.—For purposes of paragraph (1), foreign currency for which there is an active interbank market is presumed to be actively traded."

(c) REPEAL OF SPECIAL TREATMENT OF BANKS FOR HEDGING EXCEPTION.—Subsection (e) of section 1256 (relating to mark to market not to apply to hedging transactions) is amended by striking out paragraph (4) and by redesignating paragraph (5) as paragraph (4).

(d) CLERICAL AMENDMENT.—The table of subparts for part III of subchapter N of chapter 1 is amended by adding at the end thereof the following new item:

"Subpart J. Foreign currency transactions."

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Special rules for purposes of sections 902 and 960.—For purposes of applying sections 902 and 960 of the Internal Revenue Code of 1986, the amendments made by this section shall apply to—

(A) earnings and profits of the foreign corporation for taxable years beginning after December 31, 1986, and

(B) foreign taxes paid or accrued by the foreign corporation with respect to such earnings and profits.

Subtitle G—Tax Treatment of Possessions

PART I—TREATMENT OF GUAM, AMERICAN SAMOA, AND THE NORTHERN MARIANA ISLANDS

SEC. 1271. AUTHORITY OF GUAM, AMERICAN SAMOA, AND THE NORTHERN MARIANA ISLANDS TO ENACT REVENUE LAWS.

(a) In General.—Except as provided in subsection (b), nothing in the laws of the United States shall prevent Guam, American Samoa, or the Northern Mariana Islands from enacting tax laws (which shall apply in lieu of the mirror system) with respect to income—

(1) from sources within, or effectively connected with the conduct of a trade or business within, any such possession, or

(2) received or accrued by any resident of such possession.

(b) Agreements To Alleviate Certain Problems Relating to Tax Administration.—Subsection (a) shall apply to Guam, American Samoa, or the Northern Mariana Islands only if (and so long as) an implementing agreement is in effect between the United States and such possession with respect to—

(1) the elimination of double taxation involving taxation by such possession and taxation by the United States,

(2) the establishment of rules under which the evasion or avoidance of United States income tax shall not be permitted or facilitated by such possession,

(3) the exchange of information between such possession and the United States for purposes of tax administration, and

(4) the resolution of other problems arising in connection with the administration of the tax laws of such possession or the United States.

Any such implementing agreement shall be executed on behalf of the United States by the Secretary of the Treasury after consultation with the Secretary of the Interior.

(c) Revenues Not To Decrease.—The total amount of the revenue received by any possession referred to in subsection (a) pursuant to its tax laws during the implementation year and each of the 4 fiscal years thereafter shall not be less than the revenue (adjusted for inflation) which was received by such possession pursuant to tax laws for its last fiscal year before the implementation year.

(d) Nondiscriminatory Treatment Required.—Nothing in any tax law of a possession referred to in subsection (a) may discriminate against any United States person or any resident (corporate or otherwise) of any other possession.

(e) Enforcement.—

(1) In general.—If the Secretary of the Treasury (after consultation with the Secretary of the Interior) determines that any possession has failed to comply with subsection (c) or (d), the Secretary of the Treasury shall so notify the Governor of such possession in writing. If such possession does not comply with subsection (c) or (d) (as the case may be) within 90 days of such notification, the Secretary of the Treasury shall notify the Congress of such noncompliance. Unless the Congress by law provides otherwise, the mirror system of taxation shall be reinstated in such possession and shall be in full force and effect for taxable years beginning after such notification to the Congress.

(2) Special rule for revenue requirements.—If the failure to comply with subsection (c) is for good cause and does not jeopardize the fiscal integrity of the possession, the Secretary may waive the requirements of subsection (c) for such period as he determines appropriate.

(f) Definitions and Special Rules.—

(1) Implementation year.—For purposes of this section, the term "implementation year" means the 1st fiscal year of the possession in which the tax laws authorized by subsection (a) take effect.

(2) Mirror system.—For purposes of this section, the mirror system of taxation consists of the provisions of law (in effect on the day before the date of the enactment of this Act) which make the provisions of the income tax laws of the United States (as in effect from time to time) in effect in a possession of the United States.

(3) Special rule for northern mariana islands.—Notwithstanding the provisions of the last clause of section 601(a) of Public Law 94-241, the Commonwealth of the Northern Mariana Islands may elect to continue its mirror system of taxation without regard to whether Guam enacts tax laws under the authority provided in subsection (a).

SEC. 1272. EXCLUSION OF POSSESSION SOURCE INCOME FROM THE GROSS INCOME OF CERTAIN INDIVIDUALS.

(a) In General.—Section 931 (relating to income from sources within possessions of the United States) is amended to read as follows:

"SEC. 931. INCOME FROM SOURCES WITHIN GUAM, AMERICAN SAMOA, OR THE NORTHERN MARIANA ISLANDS.

"(a) General Rule.—In the case of an individual who is a bona fide resident of a specified possession during the entire taxable year, gross income shall not include—

"(1) income derived from sources within any specified possession, and

"(2) income effectively connected with the conduct of a trade or business by such individual within any specified possession.

"(b) Deductions, Etc. Allocable to Excluded Amounts Not Allowable.—An individual shall not be allowed—

"(1) as a deduction from gross income any deductions (other than the deduction under section 151, relating to personal exemptions), or

"(2) any credit,

properly allocable or chargeable against amounts excluded from gross income under this section.

"(c) Specified Possession.—For purposes of this section, the term 'specified possession' means Guam, American Samoa, and the Northern Mariana Islands.

"(d) Special Rules.—For purposes of this section—

"(1) Employees of the united states.—Amounts paid for services performed as an employee of the United States (or any agency thereof) shall be treated as not described in paragraph (1) or (2) of subsection (a).

"(2) Determination of source, etc.—The determination as to whether income is described in paragraph (1) or (2) of subsection (a) shall be made under regulations prescribed by the Secretary.

"(3) Determination of residency.—For purposes of this section and section 876, the determination of whether an individual is a bona fide resident of Guam, American Samoa, or the Northern Mariana Islands shall be made under regulations prescribed by the Secretary."

(b) Exemption From Withholding Tax; Tax Imposed by Section 1.—Section 876 (relating to alien residents of Puerto Rico) is amended to read as follows:

"SEC. 876. ALIEN RESIDENTS OF PUERTO RICO, GUAM, AMERICAN SAMOA, OR THE NORTHERN MARIANA ISLANDS.

"(a) General Rule.—This subpart shall not apply to any alien individual who is a bona fide resident of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands during the entire taxable year and such alien shall be subject to the tax imposed by section 1.

"(b) Cross References.—

"For exclusion from gross income of income derived from sources within—

"(1) Guam, American Samoa, and the Northern Mariana Islands, see section 931, and

"(2) Puerto Rico, see section 933."

(c) Exemption From Wage Withholding for Certain Services Performed in Possessions.—Paragraph (8) of section 3401(a) (defining wages) is amended by adding at the end thereof the following new subparagraph:

"(D) for services for the United States (or any agency thereof) performed by a citizen of the United States within a possession of the United States to the extent the United States (or such agency) withholds taxes on such remuneration pursuant to an agreement with such possession; or".

(d) Technical and Conforming Amendments.—

(1) Section 932 (relating to citizens of possessions of the United States) is hereby repealed.

(2) Section 935 (relating to coordination of United States and Guam individual income taxes) is hereby repealed.

(3) Paragraphs (1) and (2) of section 933 are each amended by inserting ", or any credit," before "properly".

(4) Subparagraph (C) of section 32(c)(1) is amended to read as follows:

"(C) INDIVIDUAL WHO CLAIMS BENEFITS OF SECTION 911 NOT ELIGIBLE INDIVIDUAL.—The term 'eligible individual' does not include an individual who, for the taxable year, claims the benefits of section 911 (relating to citizens or residents of the United States living abroad)."

(5) Clause (vii) of section 48(a)(2)(B) is amended by striking out "932,".

(6) Paragraph (6) of section 63(c) (relating to certain individuals, etc., not eligible for standard deduction), as amended by title I of this Act, is amended by striking out subparagraph (C) and by redesignating subparagraphs (D) and (E) as subparagraphs (C) and (D), respectively.

(7) Section 153 is amended by striking out paragraph (4) and by redesignating paragraph (5) as paragraph (4).

(8) Paragraph (8) of section 1402(a) is amended by striking out "and section 931 (relating to income from sources within possessions of the United States)" and by inserting "and" after "of the employer),".

(9) Paragraph (9) of section 1402(a) is amended to read as follows:

"(9) the exclusion from gross income provided by section 931 shall not apply;".

(10) Clause (iii) of section 6091(b)(1)(B) is amended by striking out "possessions of the United States" and inserting in lieu thereof "Guam, American Samoa, or the Northern Mariana Islands".

(11) Subsection (b) of section 7655 is amended by redesignating paragraphs (1) and (2) as paragraphs (2) and (3), respectively, and by inserting before paragraph (2), as so redesignated, the following new paragraph:

"(1) Section 931, relating to income tax on residents of Guam, American Samoa, or the Northern Mariana Islands;".

(12) The table of sections for subpart D of part III of subchapter N of chapter 1 is amended by striking out the items relating to sections 932 and 935 and by striking out the item relating to section 931 and inserting in lieu thereof the following:

"Sec. 931. Income from sources within Guam, American Samoa, or the Northern Mariana Islands."

(13) The table of sections for subpart A of part II of subchapter N of chapter 1 is amended by striking out the item relating to section 876 and inserting in lieu thereof the following:

"Sec. 876. Alien residents of Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands."

SEC. 1273. TREATMENT OF CORPORATIONS ORGANIZED IN GUAM, AMERICAN SAMOA, OR THE NORTHERN MARIANA ISLANDS.

(a) TREATMENT UNDER SUBPART F.—Subsection (c) of section 957 (relating to controlled foreign corporations; United States persons), as amended by section 1224, is amended by adding "and" at the end of paragraph (1) and by striking out paragraphs (2) and (3) and inserting in lieu thereof the following new paragraph:

"(2) with respect to a corporation organized under the laws of Guam, American Samoa, or the Northern Mariana Islands—

"(A) 80 percent or more of the gross income of which for the 3-year period ending at the close of the taxable year (or for such part of such period as such corporation or any predecessor has been in existence) was derived from sources within such a possession or was effectively connected with the conduct of a trade or business in such a possession, and

"(B) 50 percent or more of the gross income of which for such period (or part) was derived from the conduct of an active trade or business within such a possession,

such term does not include an individual who is a bona fide resident of Guam, American Samoa, or the Northern Mariana Islands.

For purposes of subparagraphs (A) and (B) of paragraph (2), the determination as to whether income was derived from sources within a possession, was effectively connected with the conduct of a trade or business within a possession, or derived from the active conduct of a trade or business within a possession shall be made under regulations prescribed by the Secretary."

(b) Exemption From Withholding.—

(1) In general.—Subsection (b) of section 881 (relating to exception for certain Guam and Virgin Islands corporations) is amended by striking out paragraphs (1) and (2) and inserting in lieu thereof the following:

"(1) In general.—For purposes of this section and section 884, a corporation created or organized in Guam, American Samoa, the Northern Mariana Islands, or the Virgin Islands or under the law of any such possession shall not be treated as a foreign corporation for any taxable year if—

"(A) at all times during such taxable year less than 25 percent in value of the stock of such corporation is beneficially owned (directly or indirectly) by foreign persons,

"(B) at least 65 percent of the gross income of such corporation is shown to the satisfaction of the Secretary to be effectively connected with the conduct of a trade or business in such a possession or the United States for the 3-year period ending with the close of the taxable year of such corporation (or for such part of such period as the corporation or any predecessor has been in existence), and

"(C) no substantial part of the income of such corporation is used (directly or indirectly) to satisfy obligations to persons who are not bona fide residents of such a possession or the United States."

(2) Technical amendments.—

(A) Subsection (b) of section 881 is amended by redesignating paragraph (3) as paragraph (2) and by striking out paragraph (4).

(B) Subsection (c) of section 1442 is amended to read as follows:

"(c) Exception for Certain Possessions Corporations.—For purposes of this section, the term 'foreign corporation' does not include a corporation created or organized in Guam, American Samoa, the Northern Mariana Islands, or the Virgin Islands or under the law of any such possession if the requirements of subpara-

graphs (A), (B), and (C) of section 881(b)(1) are met with respect to such corporation."

PART II—TREATMENT OF THE VIRGIN ISLANDS

SEC. 1274. COORDINATION OF UNITED STATES AND VIRGIN ISLANDS INCOME TAXES.

(a) IN GENERAL.—Subpart D of part III of subchapter N of chapter 1 is amended by inserting after section 931 the following new section:

"SEC. 932. COORDINATION OF UNITED STATES AND VIRGIN ISLANDS INCOME TAXES.

"(a) TREATMENT OF UNITED STATES RESIDENTS.—

"(1) APPLICATION OF SUBSECTION.—This subsection shall apply to an individual for the taxable year if—

"(A) such individual—

"(i) is a citizen or resident of the United States (other than a bona fide resident of the Virgin Islands at the close of the taxable year), and

"(ii) has income derived from sources within the Virgin Islands, or effectively connected with the conduct of a trade or business within such possession, for the taxable year, or

"(B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).

"(2) FILING REQUIREMENT.—Each individual to whom this subsection applies for the taxable year shall file his income tax return for the taxable year with both the United States and the Virgin Islands.

"(3) EXTENT OF INCOME TAX LIABILITY.—In the case of an individual to whom this subsection applies in a taxable year for purposes of so much of this title (other than this section and section 7654) as relates to the taxes imposed by this chapter, the United States shall be treated as including the Virgin Islands.

"(b) PORTION OF UNITED STATES TAX LIABILITY PAYABLE TO THE VIRGIN ISLANDS.—

"(1) IN GENERAL.—Each individual to whom subsection (a) applies for the taxable year shall pay the applicable percentage of the taxes imposed by this chapter for such taxable year (determined without regard to paragraph (3)) to the Virgin Islands.

"(2) APPLICABLE PERCENTAGE.—

"(A) IN GENERAL.—For purposes of paragraph (1), the term 'applicable percentage' means the percentage which Virgin Islands adjusted gross income bears to adjusted gross income.

"(B) VIRGIN ISLANDS ADJUSTED GROSS INCOME.—For purposes of subparagraph (A), the term 'Virgin Islands adjusted gross income' means adjusted gross income determined by taking into account only income derived from sources within the Virgin Islands and deductions properly apportioned or allocable thereto.

"(3) AMOUNTS PAID ALLOWED AS CREDIT.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year an amount equal to the taxes required to be *paid to the Virgin Islands under paragraph (1) which are so paid.*

"(c) Treatment of Virgin Islands Residents.—

"(1) Application of subsection.—This subsection shall apply to an individual for the taxable year if—

"(A) such individual is a bona fide resident of the Virgin Islands at the close of the taxable year, or

"(B) such individual files a joint return for the taxable year with an individual described in subparagraph (A).

"(2) Filing requirement.—Each individual to whom this subsection applies for the taxable year shall file his income tax return for the taxable year with the Virgin Islands.

"(3) Extent of income tax liability.—In the case of an individual to whom this subsection applies in a taxable year for purposes of so much of this title (other than this section and section 7654) as relates to the taxes imposed by this chapter, the Virgin Islands shall be treated as including the United States.

"(4) Residents of the virgin islands.—In the case of an individual who is a bona fide resident of the Virgin Islands at the close of the taxable year and who, on his return of income tax to the Virgin Islands, reports income from all sources and identifies the source of each item shown on such return, for purposes of calculating income tax liability to the United States gross income shall not include any amount included in gross income on such return.

"(d) Special Rule for Joint Returns.—In the case of a joint return, this section shall be applied on the basis of the residence of the spouse who has the greater adjusted gross income (determined without regard to community property laws) for the taxable year.

"(e) Section Not To Apply to Tax Imposed in Virgin Islands.—This section shall not apply for purposes of determining income tax liability incurred to the Virgin Islands."

(b) Authority To Impose Nondiscriminatory Local Income Taxes.—Nothing in any provision of Federal law shall prevent the Virgin Islands from imposing on any person nondiscriminatory local income taxes. Any taxes so imposed shall be treated in the same manner as State and local income taxes under section 164 of the Internal Revenue Code of 1954 and shall not be treated as taxes to which section 901 of such Code applies.

(c) Regulations on Application of Mirror System.—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary or appropriate for applying this title for purposes of determining tax liability incurred to the Virgin Islands.

(d) Clerical Amendment.—The table of sections for such subpart D is amended by inserting after the item relating to section 931 the following new item:

"Sec. 932. Coordination of United States and Virgin Islands income taxes."

SEC. 1275. VIRGIN ISLANDS CORPORATIONS ALLOWED POSSESSION TAX CREDIT.

(a) Possession Tax Credit Allowed.—

(1) In general.—Paragraph (1) of section 936(d) (defining possession) is amended by striking out ", but does not include

the Virgin Islands of the United States" and inserting in lieu thereof "and the Virgin Islands".

(2) CONFORMING AMENDMENTS.—

(A) Section 934 is amended by striking out subsections (e) and (f).

(B) Subsection (e) of section 246 is amended by striking out "or 934(e)(3)".

(b) CLARIFICATION OF TREATMENT OF VIRGIN ISLANDS INHABITANTS.—Subparagraph (B) of section 7651(5) (relating to the Virgin Islands) is amended to read as follows:

"(B) For purposes of this title, section 28(a) of the Revised Organic Act of the Virgin Islands shall be effective as if such section 28(a) had been enacted before the enactment of this title and such section 28(a) shall have no effect on the amount of income tax liability required to be paid by any person to the United States."

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Subsection 934 is amended by striking out subsections (b), (c), and (d).

(2)(A) Subsection (a) of section 934 is amended by striking out "or (c) or in section 934A".

(B) Section 934, as amended by paragraph (1), is amended by inserting after subsection (a) the following new subsection:

"(b) REDUCTIONS PERMITTED WITH RESPECT TO CERTAIN INCOME.—

"(1) IN GENERAL.—Except as provided in paragraph (2), subsection (a) shall not apply with respect to so much of the tax liability referred to in subsection (a) as is attributable to income derived from sources within the Virgin Islands or income effectively connected with the conduct of a trade or business within the Virgin Islands.

"(2) EXCEPTION FOR LIABILITY PAID BY CITIZENS OR RESIDENTS OF THE UNITED STATES.—Paragraph (1) shall not apply to any liability payable to the Virgin Islands under section 932(b).

"(3) SPECIAL RULE FOR NON-UNITED STATES INCOME OF CERTAIN FOREIGN CORPORATIONS.—

"(A) IN GENERAL.—In the case of a qualified foreign corporation, subsection (a) shall not apply with respect to so much of the tax liability referred to in subsection (a) as is attributable to income which is derived from sources outside the United States and which is not effectively connected with the conduct of a trade or business within the United States.

"(B) QUALIFIED FOREIGN CORPORATION.—For purposes of subparagraph (A), the term 'qualified foreign corporation' means any foreign corporation if less than 10 percent of—

"(i) the total voting power of the stock of such corporation, and

"(ii) the total value of the stock of such corporation, is owned or treated as owned (within the meaning of section 958) by 1 or more United States persons.

"(4) DETERMINATION OF INCOME SOURCE, ETC.—The determination as to whether income is derived from sources within the Virgin Islands or the United States or is effectively connected

with the conduct of a trade or business within the Virgin Islands or the United States shall be made under regulations prescribed by the Secretary."

(3) Section 934A (relating to income tax rates on Virgin Islands source income) is hereby repealed.

(4) Subparagraph (B) of section 28(d)(3) is amended to read as follows:

> *"(B) Special limitation for corporations to which section 936 applies.—No credit shall be allowed under this section with respect to any clinical testing conducted by a corporation to which an election under section 936 applies."*

(5) Clause (vii) of section 48(a)(2)(B) is amended by striking out "or which is entitled to the benefits of section 934(b)" and by striking out ", 933, or 934(c)" and inserting in lieu thereof "or 933".

(6) Clause (i) of section 338(h)(6)(B) is amended by striking out "a corporation described in section 934(b),".

(7) Subparagraph (B) of section 864(d)(5) is amended to read as follows:

> *"(B) Special rules for possessions.—An amount treated as interest under paragraph (1) shall not be treated as income described in subparagraph (A) or (B) of section 936(a)(1) unless such amount is from sources within a possession of the United States (determined after the application of paragraph (1))."*

(8) The table of sections for subpart D of part III of subchapter N of chapter 1 is amended by striking out the item relating to section 934A.

PART III—COVER OVER OF INCOME TAXES

SEC. 1276. COVER OVER OF INCOME TAXES.

(a) In General.—Section 7654 (relating to coordination of United States and Guam individual income taxes) is amended to read as follows:

"SEC. 7654. COORDINATION OF UNITED STATES AND CERTAIN POSSESSION INDIVIDUAL INCOME TAXES.

"(a) General Rule.—The net collection of taxes imposed by chapter 1 for each taxable year with respect to an individual to which section 931 or 932(c) applies shall be covered into the Treasury of the specified possession of which such individual is a bona fide resident.

"(b) Definition and Special Rule.—For purposes of this section—

> *"(1) Net collections.—In determining net collections for a taxable year, an appropriate adjustment shall be made for credits allowed against the tax liability and refunds made of income taxes for the taxable year.*
>
> *"(2) Specified possession.—The term 'specified possession' means Guam, American Samoa, the Northern Mariana Islands, and the Virgin Islands.*

"(c) TRANSFERS.—*The transfers of funds between the United States and any specified possession required by this section shall be made not less frequently than annually.*

"(d) FEDERAL PERSONNEL.—*In addition to the amount determined under subsection (a), the United States shall pay to each specified possession at such times and in such manner as determined by the Secretary—*

"(1) *the amount of the taxes deducted and withheld by the United States under chapter 24 with respect to compensation paid to members of the Armed Forces who are stationed in such possession but who have no income tax liability to such possession with respect to such compensation by reason of the Soldiers' and Sailors' Civil Relief Act (50 App. U.S.C. 501 et seq.), and*

"(2) *the amount of the taxes deducted and withheld under chapter 24 with respect to amounts paid for services performed as an employee of the United States (or any agency thereof) in a specified possession with respect to an individual unless section 931 or 932(c) applies.*

"(e) REGULATIONS.—*The Secretary shall prescribe such regulations as may be necessary to carry out the provisions of this section and sections 931 and 932, including regulations prohibiting the rebate of taxes covered over which are allocable to United States source income and prescribing the information which the individuals to whom such sections may apply shall furnish to the Secretary."*

(b) CLERICAL AMENDMENT.—*The table of sections for subchapter D of chapter 78 is amended by striking out the item relating to section 7654 and inserting in lieu thereof the following:*

"*Sec. 7654. Coordination of United States and certain possession individual income taxes.*"

PART IV—EFFECTIVE DATE

SEC. 1277. EFFECTIVE DATE.

(a) IN GENERAL.—*Except as otherwise provided in this section, the amendments made by this subtitle shall apply to taxable years beginning after December 31, 1986.*

(b) SPECIAL RULE FOR GUAM, AMERICAN SAMOA, AND THE NORTHERN MARIANA ISLANDS.—*The amendments made by this subtitle shall apply with respect to Guam, American Samoa, or the Northern Mariana Islands (and to residents thereof and corporations created or organized therein) only if (and so long as) an implementing agreement under section 1271 is in effect between the United States and such possession.*

(c) SPECIAL RULES FOR THE VIRGIN ISLANDS.—

(1) IN GENERAL.—*The amendments made by section 1275(c) shall apply with respect to the Virgin Islands (and residents thereof and corporations created or organized therein) only if (and so long as) an implementing agreement is in effect between the United States and the Virgin Islands with respect to the establishment of rules under which the evasion or avoidance of United States income tax shall not be permitted or facilitated by such possession. Any such implementing agreement shall be*

executed on behalf of the United States by the Secretary of the Treasury, after consultation with the Secretary of the Interior.

(2) SECTION 1275(b).—

(A) IN GENERAL.—The amendment made by section 1275(b) shall apply with respect to—

(i) any taxable year beginning after December 31, 1986, and

(ii) any pre-1987 open year.

(B) SPECIAL RULES.—In the case of any pre-1987 open year—

(i) the amendment made by section 1275(b) shall not apply to income from sources in the Virgin Islands or income effectively connected with the conduct of a trade or business in the Virgin Islands, and

(ii) the taxpayer shall be allowed a credit—

(I) against any additional tax imposed by subtitle A of the Internal Revenue Code of 1954 (by reason of the amendment made by section 1275(b)) on income not described in clause (i) and from sources in the United States,

(II) for any tax paid to the Virgin Islands before the date of the enactment of this Act and attributable to such income.

For purposes of clause (ii)(II), any tax paid before January 1, 1987, pursuant to a process in effect before August 16, 1986, shall be treated as paid before the date of the enactment of this Act.

(C) PRE-1987 OPEN YEAR.—For purposes of this paragraph, the term "pre-1987 open year" means any taxable year beginning before January 1, 1987, if on the date of the enactment of this Act the assessment of a deficiency of income tax for such taxable year is not barred by any law or rule of law.

(D) EXCEPTION.—In the case of any pre-1987 open year, the amendment made by section 1275(b) shall not apply to any domestic corporation if—

(i) during the fiscal year which ended May 31, 1986, such corporation was actively engaged directly or through a subsidiary in the conduct of a trade or business in the Virgin Islands and such trade or business consists of business related to marine activities, and

(ii) such corporation was incorporated on March 31, 1983, in Delaware.

(E) EXCEPTION FOR CERTAIN TRANSACTIONS.—

(i) IN GENERAL.—In the case of any pre-1987 open year, the amendment made by section 1275(b) shall not apply to any income derived from transactions described in clause (ii) by 1 or more corporations which were formed in Delaware on or about March 6, 1981, and which have owned 1 or more office buildings in St. Thomas, United States Virgin Islands, for at least 5 years before the date of the enactment of this Act.

(ii) DESCRIPTION OF TRANSACTIONS.—The transactions described in this clause are—

(I) the redemptions of limited partnership interests for cash and property described in an agreement (as amended) dated March 12, 1981,

(II) the subsequent disposition of the properties distributed in such redemptions, and

(III) interest earned before January 1, 1987, on bank deposits of proceeds received from such redemptions to the extent such deposits are located in the United States Virgin Islands.

(iii) LIMITATION.—The aggregate reduction in tax by reason of this subparagraph shall not exceed $8,312,000. If the taxes which would be payable as the result of the application of the amendment made by section 1275(b) to pre-1987 open years exceeds the limitation of the preceding sentence, such excess shall be treated as attributable to income received in taxable years in reverse chronological order.

(d) REPORT ON IMPLEMENTING AGREEMENTS.—If, during the 1-year period beginning on the date of the enactment of this Act, any implementing agreement described in subsection (b) or (c) is not executed, the Secretary of the Treasury or his delegate shall report to the Committee on Finance of the United States Senate, the Committee on Ways and Means, and the Committee on Interior and Insular Affairs of the House of Representatives with respect to—

(1) the status of such negotiations, and

(2) the reason why such agreement has not been executed.

(e) TREATMENT OF CERTAIN UNITED STATES PERSONS.—Except as otherwise provided in regulations prescribed by the Secretary of the Treasury or his delegate, if a United States person becomes a resident of Guam, American Samoa, or the Northern Mariana Islands, the rules of section 877(c) of the Internal Revenue Code of 1954 shall apply to such person during the 10-year period beginning when such person became such a resident. The preceding sentence shall apply to dispositions after December 31, 1985, in taxable years ending after such date.

TITLE XIII—TAX-EXEMPT BONDS

Subtitle A—Amendments of Internal Revenue Code of 1954

SEC. 1301. STATE AND LOCAL BONDS.

(a) EXCLUSION FOR INTEREST ON BONDS WHICH MEET CERTAIN REQUIREMENTS.—Section 103 (relating to interest on certain governmental obligations) is amended to read as follows:

"SEC. 103. INTEREST ON STATE AND LOCAL BONDS.

"(a) EXCLUSION.—Except as provided in subsection (b), gross income does not include interest on any State or local bond.

"(b) EXCEPTIONS.—Subsection (a) shall not apply to—

"(1) PRIVATE ACTIVITY BOND WHICH IS NOT A QUALIFIED BOND.—Any private activity bond which is not a qualified bond (within the meaning of section 141).

"(2) ARBITRAGE BOND.—Any arbitrage bond (within the meaning of section 148).

"(3) BOND NOT IN REGISTERED FORM, ETC.—Any bond unless such bond meets the applicable requirements of section 149.

"(c) DEFINITIONS.—For purposes of this section and part IV—

"(1) STATE OR LOCAL BOND.—The term 'State or local bond' means an obligation of a State or political subdivision thereof.

"(2) STATE.—The term 'State' includes the District of Columbia and any possession of the United States."

(b) TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS.—Part IV of subchapter B of chapter 1 (relating to determination of marital status) is amended to read as follows:

"PART IV—TAX EXEMPTION REQUIREMENTS FOR STATE AND LOCAL BONDS

"Subpart A. Private activity bonds.
"Subpart B. Requirements applicable to all State and local bonds.
"Subpart C. Definitions and special rules.

"Subpart A—Private Activity Bonds

"Sec. 141. Private activity bond; qualified bond.
"Sec. 142. Exempt facility bond.
"Sec. 143. Mortgage revenue bonds: qualified mortgage bond and qualified veterans' mortgage bond.
"Sec. 144. Qualified small issue bond; qualified student loan bond; qualified redevelopment bond.
"Sec. 145. Qualified 501(c)(3) bond.
"Sec. 146. Volume cap.
"Sec. 147. Other requirements applicable to certain private activity bonds.

"SEC. 141. PRIVATE ACTIVITY BOND; QUALIFIED BOND.

"(a) PRIVATE ACTIVITY BOND.—For purposes of this title, the term 'private activity bond' means any bond issued as part of an issue—

"(1) which meets—

"(A) the private business use test of paragraph (1) of subsection (b), and

"(B) the private security or payment test of paragraph (2) of subsection (b), or

"(2) which meets the private loan financing test of subsection (c).

"(b) PRIVATE BUSINESS TESTS.—

"(1) PRIVATE BUSINESS USE TEST.—Except as otherwise provided in this subsection, an issue meets the test of this paragraph if more than 10 percent of the proceeds of the issue are to be used for any private business use.

"(2) PRIVATE SECURITY OR PAYMENT TEST.—Except as otherwise provided in this subsection, an issue meets the test of this paragraph if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly—

"(A) secured by any interest in—

"(i) property used or to be used for a private business use, or

"(ii) payments in respect of such property, or

"(B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

"(3) 5 PERCENT TEST FOR PRIVATE BUSINESS USE NOT RELATED OR DISPROPORTIONATE TO GOVERNMENT USE FINANCED BY THE ISSUE.—

"(A) IN GENERAL.—An issue shall be treated as meeting the tests of paragraphs (1) and (2) if such tests would be met if such paragraphs were applied—

"(i) by substituting '5 percent' for '10 percent' each place it appears, and

"(ii) by taking into account only—

"(I) the proceeds of the issue which are to be used for any private business use which is not related to any government use of such proceeds,

"(II) the disproportionate related business use proceeds of the issue, and

"(III) payments, property, and borrowed money with respect to any use of proceeds described in subclause (I) or (II).

"(B) DISPROPORTIONATE RELATED BUSINESS USE PROCEEDS.—For purposes of subparagraph (A), the disproportionate related business use proceeds of an issue is an amount equal to the aggregate of the excesses (determined under the following sentence) for each private business use of the proceeds of an issue which is related to a government use of such proceeds. The excess determined under this sentence is the excess of—

"(i) the proceeds of the issue which are to be used for the private business use over

"(ii) the proceeds of the issue which are to be used for the government use to which such private business use relates.

"(4) LOWER LIMITATION FOR CERTAIN OUTPUT FACILITIES.—An issue 5 percent or more of the proceeds of which are to be used with respect to any output facility (other than a facility for the furnishing of water) shall be treated as meeting the tests of paragraphs (1) and (2) if the nonqualified amount with respect to such issue exceeds the excess of—

"(A) $15,000,000, over

"(B) the aggregate nonqualified amounts with respect to all prior tax-exempt issues 5 percent or more of the proceeds of which are or will be used with respect to such facility (or any other facility which is part of the same project).

There shall not be taken into account under subparagraph (B) any bond which is not outstanding at the time of the later issue or which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue.

"(5) COORDINATION WITH VOLUME CAP WHERE NONQUALIFIED AMOUNT EXCEEDS $15,000,000.—If the nonqualified amount with respect to an issue—

"(A) exceeds $15,000,000, but

"(B) does not exceed the amount which would cause a bond which is part of such issue to be treated as a private activity bond without regard to this paragraph,

such bond shall nonetheless be treated as a private activity bond unless the issuer allocates a portion of its volume cap under section 146 to such issue in an amount equal to the excess of such nonqualified amount over $15,000,000.

"(6) Private business use defined.—

"(A) In general.—For purposes of this subsection, the term 'private business use' means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account.

"(B) Clarification of trade or business.—For purposes of the 1st sentence of subparagraph (A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

"(7) Government use.—The term 'government use' means any use other than a private business use.

"(8) Nonqualified amount.—For purposes of this subsection, the term 'nonqualified amount' means, with respect to an issue, the lesser of—

"(A) the proceeds of such issue which are to be used for any private business use, or

"(B) the proceeds of such issue with respect to which there are payments (or property or borrowed money) described in paragraph (2).

"(9) Exception for qualified 501(c)(3) bonds.—There shall not be taken into account under this subsection or subsection (c) the portion of the proceeds of an issue which (if issued as a separate issue) would be treated as a qualified 501(c)(3) bond if the issuer elects to treat such portion as a qualified 501(c)(3) bond.

"(c) Private Loan Financing Test.—

"(1) In general.—An issue meets the test of this subsection if the amount of the proceeds of the issue which are to be used (directly or indirectly) to make or finance loans (other than loans described in paragraph (2)) to persons other than governmental units exceeds the lesser of—

"(A) 5 percent of such proceeds, or

"(B) $5,000,000.

"(2) Exception for tax assessment, etc., loans.—For purposes of paragraph (1), a loan is described in this paragraph if such loan—

"(A) enables the borrower to finance any governmental tax or assessment of general application for a specific essential governmental function, or

"(B) is a nonpurpose investment (within the meaning of section 148(f)(6)(A)).

"(d) Qualified Bond.—For purposes of this part, the term 'qualified bond' means any private activity bond if—

"(1) In general.—Such bond is—

"(A) an exempt facility bond,

"(B) a qualified mortgage bond,

"(C) a qualified veterans' mortgage bond,

"(D) a qualified small issue bond,

"(E) a qualified student loan bond,

"(F) a qualified redevelopment bond, or

"(G) a qualified 501(c)(3) bond.

"(2) VOLUME CAP.—Such bond is issued as part of an issue which meets the applicable requirements of section 146, and

"(3) OTHER REQUIREMENTS.—Such bond meets the applicable requirements of each subsection of section 147.

"SEC. 142. EXEMPT FACILITY BOND.

"(a) GENERAL RULE.—For purposes of this part, the term 'exempt facility bond' means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide—

"(1) airports,

"(2) docks and wharves,

"(3) mass commuting facilities,

"(4) facilities for the furnishing of water,

"(5) sewage facilities,

"(6) solid waste disposal facilities,

"(7) qualified residential rental projects,

"(8) facilities for the local furnishing of electric energy or gas,

"(9) local district heating or cooling facilities, or

"(10) qualified hazardous waste facilities.

"(b) SPECIAL EXEMPT FACILITY BOND RULES.—For purposes of subsection (a)—

"(1) CERTAIN FACILITIES MUST BE GOVERNMENTALLY OWNED.—

"(A) IN GENERAL.—A facility shall be treated as described in paragraph (1), (2), or (3) of subsection (a) only if all of the property to be financed by the net proceeds of the issue is to be owned by a governmental unit.

"(B) SAFE HARBOR FOR LEASES AND MANAGEMENT CONTRACTS.—For purposes of subparagraph (A), property leased by a governmental unit shall be treated as owned by such governmental unit if—

"(i) the lessee makes an irrevocable election (binding on the lessee and all successors in interest under the lease) not to claim depreciation or an investment credit with respect to such property,

"(ii) the lease term (as defined in 168(i)(3)) is not more than 80 percent of the reasonably expected economic life of the property (as determined under section 147(b)), and

"(iii) the lessee has no option to purchase the property other than at fair market value (as of the time such option is exercised).

Rules similar to the rules of the preceding sentence shall apply to management contracts and similar types of operating agreements.

"(2) LIMITATION ON OFFICE SPACE.—An office shall not be treated as described in a paragraph of subsection (a) unless—

"(A) the office is located on the premises of a facility described in such a paragraph, and

"(B) not more than a de minimis amount of the functions to be performed at such office is not directly related to the day-to-day operations at such facility.

"(c) Airports, Docks and Wharves, and Mass Commuting Facilities.—For purposes of subsection (a)—

"(1) Storage and training facilities.—Storage or training facilities directly related to a facility described in paragraph (1), (2), or (3) of subsection (a) shall be treated as described in the paragraph in which such facility is described.

"(2) Exception for certain private facilities.—Property shall not be treated as described in paragraph (1), (2), or (3) of subsection (a) if such property is described in any of the following subparagraphs and is to be used for any private business use (as defined in section 141(b)(6)).

"(A) Any lodging facility.

"(B) Any retail facility (including food and beverage facilities) in excess of a size necessary to serve passengers and employees at the exempt facility.

"(C) Any retail facility (other than parking) for passengers or the general public located outside the exempt facility terminal.

"(D) Any office building for individuals who are not employees of a governmental unit or of the operating authority for the exempt facility.

"(E) Any industrial park or manufacturing facility.

"(d) Qualified Residential Rental Project.—For purposes of this section—

"(1) In general.—The term 'qualified residential rental project' means any project for residential rental property if, at all times during the qualified project period, such project meets the requirements of subparagraph (A) or (B), whichever is elected by the issuer at the time of the issuance of the issue with respect to such project:

"(A) 20–50 test.—The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income.

"(B) 40–60 test.—The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income.

For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

"(2) Definitions and special rules.—For purposes of this subsection—

"(A) Qualified project period.—The term 'qualified project period' means the period beginning on the 1st day on which 10 percent of the residential units in the project are occupied and ending on the latest of—

"(i) the date which is 15 years after the date on which 50 percent of the residential units in the project are occupied,

"(ii) the 1st day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or

"(iii) the date on which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

"(B) INCOME OF INDIVIDUALS; AREA MEDIAN GROSS INCOME.—The income of individuals and area median gross income shall be determined by the Secretary in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937 (or, if such program is terminated, under such program as in effect immediately before such termination). Determinations under the preceding sentence shall include adjustments for family size.

"(3) CURRENT INCOME DETERMINATIONS.—For purposes of this subsection—

"(A) IN GENERAL.—The determination of whether the income of a resident of a unit in a project exceeds the applicable income limit shall be made at least annually on the basis of the current income of the resident.

"(B) CONTINUING RESIDENT'S INCOME MAY INCREASE ABOVE THE APPLICABLE LIMIT.—If the income of a resident of a unit in a project did not exceed the applicable income limit upon commencement of such resident's occupancy of such unit (or as of any prior determination under subparagraph (A)), the income of such resident shall be treated as continuing to not exceed the applicable income limit. The preceding sentence shall cease to apply to any resident whose income as of the most recent determination under subparagraph (A) exceeds 140 percent of the applicable income limit if after such determination, but before the next determination, any residential unit of comparable or smaller size in the same project is occupied by a new resident whose income exceeds the applicable income limit.

"(4) SPECIAL RULE IN CASE OF DEEP RENT SKEWING.—

"(A) IN GENERAL.—In the case of any project described in subparagraph (B), the 2d sentence of subparagraph (B) of paragraph (3) shall be applied by substituting—

"(i) '170 percent' for '140 percent', and

"(ii) 'any low-income unit in the same project is occupied by a new resident whose income exceeds 40 percent of area median gross income' for 'any residential unit of comparable or smaller size in the same project is occupied by a new resident whose income exceeds the applicable income limit'.

"(B) DEEP RENT SKEWED PROJECT.—A project is described in this subparagraph if the owner of the project elects to have this paragraph apply and, at all times during the qualified project period, such project meets the requirements of clauses (i), (ii), and (iii):

"(i) The project meets the requirements of this clause if 15 percent or more of the low-income units in the *project are occupied by individuals whose income is 40 percent or less of area median gross income.*

"(ii) The project meets the requirements of this clause if the gross rent with respect to each low-income unit in the project does not exceed 30 percent of the applicable income limit which applies to individuals occupying the unit.

"(iii) The project meets the requirements of this clause if the gross rent with respect to each low-income unit in the project does not exceed ⅓ of the average rent with respect to units of comparable size which are not occupied by individuals who meet the applicable income limit.

"(C) DEFINITIONS APPLICABLE TO SUBPARAGRAPH (B).—For purposes of subparagraph (B)—

"(i) LOW-INCOME UNIT.—The term 'low-income unit' means any unit which is required to be occupied by individuals who meet the applicable income limit.

"(ii) GROSS RENT.—The term 'gross rent' includes—

"(I) any payment under section 8 of the United States Housing Act of 1937, and

"(II) any utility allowance determined by the Secretary after taking into account such determinations under such section 8.

"(5) APPLICABLE INCOME LIMIT.—For purposes of paragraphs (3) and (4), the term 'applicable income limit' means—

"(A) the limitation under subparagraph (A) or (B) of paragraph (1) which applies to the project, or

"(B) in the case of a unit to which paragraph (4)(B)(i) applies, the limitation which applies to such unit.

"(6) SPECIAL RULE FOR CERTAIN HIGH COST HOUSING AREA.—In the case of a project located in a city having 5 boroughs and a population in excess of 5,000,000, subparagraph (B) of paragraph (1) shall be applied by substituting '25 percent' for '40 percent'.

"(7) CERTIFICATION TO SECRETARY.—The operator of any project with respect to which an election was made under this subsection shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual certification as to whether such project continues to meet the requirements of this subsection. Any failure to comply with the provisions of the preceding sentence shall not affect the tax-exempt status of any bond but shall subject the operator to penalty, as provided in section 6652(j).

"(e) FACILITIES FOR THE FURNISHING OF WATER.—For purposes of subsection (a)(4), the term 'facilities for the furnishing of water' means any facility for the furnishing of water if—

"(1) the water is or will be made available to members of the general public (including electric utility, industrial, agricultural, or commercial users), and

"(2) either the facility is operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a

public service or public utility commission or other similar body of any State or political subdivision thereof.

"(f) Local Furnishing of Electric Energy or Gas.—For purposes of subsection (a)(8), the local furnishing of electric energy or gas from a facility shall only include furnishing solely within the area consisting of—

"(1) a city and 1 contiguous county, or

"(2) 2 contiguous counties.

"(g) Local District Heating or Cooling Facility.—

"(1) In general.—For purposes of subsection (a)(9), the term 'local district heating or cooling facility' means property used as an integral part of a local district heating or cooling system.

"(2) Local district heating or cooling system.—

"(A) In general.—For purposes of paragraph (1), the term 'local district heating or cooling system' means any local system consisting of a pipeline or network (which may be connected to a heating or cooling source) providing hot water, chilled water, or steam to 2 or more users for—

"(i) residential, commercial, or industrial heating or cooling, or

"(ii) process steam.

"(B) Local system.—For purposes of this paragraph, a local system includes facilities furnishing heating and cooling to an area consisting of a city and 1 contiguous county.

"(h) Qualified Hazardous Waste Facilities.—For purposes of subsection (a)(10), the term 'qualified hazardous waste facility' means any facility for the disposal of hazardous waste by incineration or entombment but only if—

"(1) the facility is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on the date of the enactment of the Tax Reform Act of 1986), and

"(2) the portion of such facility which is to be provided by the issue does not exceed the portion of the facility which is to be used by persons other than—

"(A) the owner or operator of such facility, and

"(B) any related person (within the meaning of section 144(a)(3)) to such owner or operator.

"SEC. 143. MORTGAGE REVENUE BONDS: QUALIFIED MORTGAGE BOND AND QUALIFIED VETERANS' MORTGAGE BOND.

"(a) Qualified Mortgage Bond.—

"(1) Qualified mortgage bond defined.—

"(A) In general.—For purposes of this title, the term 'qualified mortgage bond' means a bond which is issued as part of a qualified mortgage issue.

"(B) Termination on December 31, 1988.—No bond issued after December 31, 1988, may be treated as a qualified mortgage bond.

"(2) Qualified mortgage issue defined.—

"(A) Definition.—For purposes of this title, the term 'qualified mortgage issue' means an issue by a State or political subdivision thereof of 1 or more bonds, but only if—

"(i) all proceeds of such issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences,

"(ii) such issue meets the requirements of subsections (c), (d), (e), (f), (g), (h), and (i), and

"(iii) no bond which is part of such issue meets the private business tests of paragraphs (1) and (2) of section 141(b).

"(B) GOOD FAITH EFFORT TO COMPLY WITH MORTGAGE ELIGIBILITY REQUIREMENTS.—An issue which fails to meet 1 or more of the requirements of subsections (c), (d), (e), (f), and (i) shall be treated as meeting such requirements if—

"(i) the issuer in good faith attempted to meet all such requirements before the mortgages were executed,

"(ii) 95 percent or more of the proceeds devoted to owner-financing was devoted to residences with respect to which (at the time the mortgages were executed) all such requirements were met, and

"(iii) any failure to meet the requirements of such subsections is corrected within a reasonable period after such failure is first discovered.

"(C) GOOD FAITH EFFORT TO COMPLY WITH OTHER REQUIREMENTS.—An issue which fails to meet 1 or more of the requirements of subsections (g) and (h) shall be treated as meeting such requirements if—

"(i) the issuer in good faith attempted to meet all such requirements, and

"(ii) any failure to meet such requirements is due to inadvertent error after taking reasonable steps to comply with such requirements.

"(b) QUALIFIED VETERANS' MORTGAGE BOND DEFINED.—For purposes of this part, the term 'qualified veterans' mortgage bond' means any bond—

"(1) which is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide residences for veterans,

"(2) the payment of the principal and interest on which is secured by the general obligation of a State,

"(3) which is part of an issue which meets the requirements of subsections (c), (g), (i)(1), and (l), and

"(4) which does not meet the private business tests of paragraphs (1) and (2) of section 141(b).

Rules similar to the rules of subparagraphs (B) and (C) of subsection (a)(2) shall apply to the requirements specified in paragraph (3) of this subsection.

"(c) RESIDENCE REQUIREMENTS.—

"(1) FOR A RESIDENCE.—A residence meets the requirements of this subsection only if—

"(A) it is a single-family residence which can reasonably be expected to become the principal residence of the mortgagor within a reasonable time after the financing is provided, and

"(B) it is located within the jurisdiction of the authority issuing the bond.

"(2) For an issue.—An issue meets the requirements of this subsection only if all of the residences for which owner-financing is provided under the issue meet the requirements of paragraph (1).

"(d) 3-Year Requirement.—

"(1) In general.—An issue meets the requirements of this subsection only if 95 percent or more of the net proceeds of such issue are used to finance the residences of mortgagors who had no present ownership interest in their principal residences at any time during the 3-year period ending on the date their mortgage is executed.

"(2) Exceptions.—For purposes of paragraph (1), the proceeds of an issue which are used to provide—

"(A) financing with respect to targeted area residences, and

"(B) qualified home improvement loans and qualified rehabilitation loans,

shall be treated as used as described in paragraph (1).

"(3) Mortgagor's interest in residence being financed.—For purposes of paragraph (1), a mortgagor's interest in the residence with respect to which the financing is being provided shall not be taken into account.

"(e) Purchase Price Requirement.—

"(1) In general.—An issue meets the requirements of this subsection only if the acquisition cost of each residence the owner-financing of which is provided under the issue does not exceed 90 percent of the average area purchase price applicable to such residence.

"(2) Average area purchase price.—For purposes of paragraph (1), the term 'average area purchase price' means, with respect to any residence, the average purchase price of single family residences (in the statistical area in which the residence is located) which were purchased during the most recent 12-month period for which sufficient statistical information is available. The determination under the preceding sentence shall be made as of the date on which the commitment to provide the financing is made (or, if earlier, the date of the purchase of the residence).

"(3) Separate application to new residences and old residences.—For purposes of this subsection, the determination of average area purchase price shall be made separately with respect to—

"(A) residences which have not been previously occupied, and

"(B) residences which have been previously occupied.

"(4) Special rule for 2 to 4 family residences.—For purposes of this subsection, to the extent provided in regulations, the determination of average area purchase price shall be made separately with respect to 1 family, 2 family, 3 family, and 4 family residences.

"(5) Special rule for targeted area residences.—In the case of a targeted area residence, paragraph (1) shall be applied by substituting '110 percent' for '90 percent'.

"(6) EXCEPTION FOR QUALIFIED HOME IMPROVEMENT LOANS.—Paragraph (1) shall not apply with respect to any qualified home improvement loan.

"(f) INCOME REQUIREMENTS.—

"(1) IN GENERAL.—An issue meets the requirements of this subsection only if all owner-financing provided under the issue is provided for mortgagors whose family income is 115 percent or less of the applicable median family income.

"(2) DETERMINATION OF FAMILY INCOME.—For purposes of this subsection, the family income of mortgagors, and area median gross income, shall be determined by the Secretary after taking into account the regulations prescribed under section 8 of the United States Housing Act of 1937 (or, if such program is terminated, under such program as in effect immediately before such termination).

"(3) SPECIAL RULE FOR APPLYING PARAGRAPH (1) IN THE CASE OF TARGETED AREA RESIDENCES.—In the case of any financing provided under any issue for targeted area residences—

"(A) ⅓ of the amount of such financing may be provided without regard to paragraph (1), and

"(B) paragraph (1) shall be treated as satisfied with respect to the remainder of the owner financing if the family income of the mortgagor is 140 percent or less of the applicable median family income.

"(4) APPLICABLE MEDIAN FAMILY INCOME.—For purposes of this subsection, the term 'applicable median family income' means, with respect to a residence, whichever of the following is the greater:

"(A) the area median gross income for the area in which such residence is located, or

"(B) the statewide median gross income for the State in which such residence is located.

"(g) REQUIREMENTS RELATED TO ARBITRAGE.—

"(1) IN GENERAL.—An issue meets the requirements of this subsection only if such issue meets the requirements of paragraphs (2) and (3) of this subsection. Such requirements shall be in addition to the requirements of section 148 (other than subsection (f) thereof).

"(2) EFFECTIVE RATE OF MORTGAGE INTEREST CANNOT EXCEED BOND YIELD BY MORE THAN 1.125 PERCENTAGE POINTS.—

"(A) IN GENERAL.—An issue shall be treated as meeting the requirements of this paragraph only if the excess of—

"(i) the effective rate of interest on the mortgages provided under the issue, over

"(ii) the yield on the issue,

is not greater than 1.125 percentage points.

"(B) EFFECTIVE RATE OF MORTGAGE INTEREST.—

"(i) IN GENERAL.—In determining the effective rate of interest on any mortgage for purposes of this paragraph, there shall be taken into account all fees, charges, and other amounts borne by the mortgagor which are attributable to the mortgage or to the bond issue.

"(ii) Specification of some of the amounts to be treated as borne by the mortgagor.—For purposes of clause (i), the following items (among others) shall be treated as borne by the mortgagor:

"(I) all points or similar charges paid by the seller of the property, and

"(II) the excess of the amounts received from any person other than the mortgagor by any person in connection with the acquisition of the mortgagor's interest in the property over the usual and reasonable acquisition costs of a person acquiring like property where owner-financing is not provided through the use of qualified mortgage bonds or qualified veterans' mortgage bonds.

"(iii) Specification of some of the amounts to be treated as not borne by the mortgagor.—For purposes of clause (i), the following items shall not be taken into account:

"(I) any expected rebate of arbitrage profits, and

"(II) any application fee, survey fee, credit report fee, insurance charge, or similar amount to the extent such amount does not exceed amounts charged in such area in cases where owner-financing is not provided through the use of qualified mortgage bonds or qualified veterans' mortgage bonds.

Subclause (II) shall not apply to origination fees, points, or similar amounts.

"(iv) Prepayment assumptions.—In determining the effective rate of interest—

"(I) it shall be assumed that the mortgage prepayment rate will be the rate set forth in the most recent applicable mortgage maturity experience table published by the Federal Housing Administration, and

"(II) prepayments of principal shall be treated as received on the last day of the month in which the issuer reasonably expects to receive such prepayments.

"(C) Yield on the issue.—For purposes of this subsection, the yield on an issue shall be determined on the basis of—

"(i) the issue price (within the meaning of sections 1273 and 1274), and

"(ii) an expected maturity for the bonds which is consistent with the assumptions required under subparagraph (B)(iv).

"(3) Arbitrage and investment gains to be used to reduce costs of owner-financing.—

"(A) In general.—An issue shall be treated as meeting the requirements of this paragraph only if an amount equal to the sum of—

"(i) the excess of—

"(I) the amount earned on all nonpurpose investments (other than investments attributable to an excess described in this clause), over

"(II) the amount which would have been earned if such investments were invested at a rate equal to the yield on the issue, plus

"(ii) any income attributable to the excess described in clause (i),

is paid or credited to the mortgagors as rapidly as may be practicable.

"(B) INVESTMENT GAINS AND LOSSES.—For purposes of subparagraph (A), in determining the amount earned on all nonpurpose investments, any gain or loss on the disposition of such investments shall be taken into account.

"(C) REDUCTION WHERE ISSUER DOES NOT USE FULL 1.125 PERCENTAGE POINTS UNDER PARAGRAPH (2).—

"(i) IN GENERAL.—The amount required to be paid or credited to mortgagors under subparagraph (A) (determined under this paragraph without regard to this subparagraph) shall be reduced by the unused paragraph (2) amount.

"(ii) UNUSED PARAGRAPH (2) AMOUNT.—For purposes of clause (i), the unused paragraph (2) amount is the amount which (if it were treated as an interest payment made by mortgagors) would result in the excess referred to in paragraph (2)(A) being equal to 1.125 percentage points. Such amount shall be fixed and determined as of the yield determination date.

"(D) ELECTION TO PAY UNITED STATES.—Subparagraph (A) shall be satisfied with respect to any issue if the issuer elects before issuing the bonds to pay over to the United States—

"(i) not less frequently than once each 5 years after the date of issue, an amount equal to 90 percent of the aggregate amount which would be required to be paid or credited to mortgagors under subparagraph (A) (and not theretofore paid to the United States), and

"(ii) not later than 60 days after the redemption of the last bond, 100 percent of such aggregate amount not theretofore paid to the United States.

"(E) SIMPLIFIED ACCOUNTING.—The Secretary shall permit any simplified system of accounting for purposes of this paragraph which the issuer establishes to the satisfaction of the Secretary will assure that the purposes of this paragraph are carried out.

"(F) NONPURPOSE INVESTMENT.—For purposes of this paragraph, the term 'nonpurpose investment' has the meaning given such term by section 148(f)(6)(A).

"(h) PORTION OF LOANS REQUIRED TO BE PLACED IN TARGETED AREAS.—

"(1) IN GENERAL.—An issue meets the requirements of this subsection only if at least 20 percent of the proceeds of the issue which are devoted to providing owner-financing is made available (with reasonable diligence) for owner-financing of targeted

area residences for at least 1 year after the date on which owner-financing is first made available with respect to targeted area residences.

"(2) LIMITATION.—*Nothing in paragraph (1) shall be treated as requiring the making available of an amount which exceeds 40 percent of the average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences located in targeted areas within the jurisdiction of the issuing authority.*

"(i) OTHER REQUIREMENTS.—

"(1) MORTGAGES MUST BE NEW MORTGAGES.—

"(A) IN GENERAL.—*An issue meets the requirements of this subsection only if no part of the proceeds of such issue is used to acquire or replace existing mortgages.*

"(B) EXCEPTIONS.—*Under regulations prescribed by the Secretary, the replacement of—*

"(i) *construction period loans,*

"(ii) *bridge loans or similar temporary initial financing, and*

"(iii) *in the case of a qualified rehabilitation, an existing mortgage,*

shall not be treated as the acquisition or replacement of an existing mortgage for purposes of subparagraph (A).

"(2) CERTAIN REQUIREMENTS MUST BE MET WHERE MORTGAGE IS ASSUMED.—*An issue meets the requirements of this subsection only if each mortgage with respect to which owner-financing has been provided under such issue may be assumed only if the requirements of subsections (c), (d), and (e), and the requirements of paragraph (1) or (3)(B) of subsection (f) (whichever applies), are met with respect to such assumption.*

"(j) TARGETED AREA RESIDENCES.—

"(1) IN GENERAL.—*For purposes of this section, the term 'targeted area residence' means a residence in an area which is either—*

"(A) *a qualified census tract, or*

"(B) *an area of chronic economic distress.*

"(2) QUALIFIED CENSUS TRACT.—

"(A) IN GENERAL.—*For purposes of paragraph (1), the term 'qualified census tract' means a census tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median family income.*

"(B) DATA USED.—*The determination under subparagraph (A) shall be made on the basis of the most recent decennial census for which data are available.*

"(3) AREA OF CHRONIC ECONOMIC DISTRESS.—

"(A) IN GENERAL.—*For purposes of paragraph (1), the term 'area of chronic economic distress' means an area of chronic economic distress—*

"(i) *designated by the State as meeting the standards established by the State for purposes of this subsection, and*

"(ii) *the designation of which has been approved by the Secretary and the Secretary of Housing and Urban Development.*

"(B) Criteria to be used in approving State designations.—The criteria used by the Secretary and the Secretary of Housing and Urban Development in evaluating any proposed designation of an area for purposes of this subsection shall be—

"(i) the condition of the housing stock, including the age of the housing and the number of abandoned and substandard residential units,

"(ii) the need of area residents for owner-financing under this section, as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates,

"(iii) the potential for use of owner-financing under this section to improve housing conditions in the area, and

"(iv) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

"(k) Other Definitions and Special Rules.—For purposes of this section—

"(1) Mortgage.—The term 'mortgage' means any owner-financing.

"(2) Statistical area.—

"(A) In general.—The term 'statistical area' means—

"(i) a metropolitan statistical area, and

"(ii) any county (or the portion thereof) which is not within a metropolitan statistical area.

"(B) Metropolitan statistical area.—The term 'metropolitan statistical area' includes the area defined as such by the Secretary of Commerce.

"(C) Designation where adequate statistical information not available.—For purposes of this paragraph, if there is insufficient recent statistical information with respect to a county (or portion thereof) described in subparagraph (A)(ii), the Secretary may substitute for such county (or portion thereof) another area for which there is sufficient recent statistical information.

"(D) Designation where no county.—In the case of any portion of a State which is not within a county, subparagraphs (A)(ii) and (C) shall be applied by substituting for 'county' an area designated by the Secretary which is the equivalent of a county.

"(3) Acquisition cost.—

"(A) In general.—The term 'acquisition cost' means the cost of acquiring the residence as a completed residential unit.

"(B) Exceptions.—The term 'acquisition cost' does not include—

"(i) usual and reasonable settlement or financing costs,

"(ii) the value of services performed by the mortgagor or members of his family in completing the residence, and

"(iii) the cost of land which has been owned by the mortgagor for at least 2 years before the date on which construction of the residence begins.

"(C) SPECIAL RULE FOR QUALIFIED REHABILITATION LOANS.—In the case of a qualified rehabilitation loan, for purposes of subsection (e), the term 'acquisition cost' includes the cost of the rehabilitation.

"(4) QUALIFIED HOME IMPROVEMENT LOAN.—The term 'qualified home improvement loan' means the financing (in an amount which does not exceed $15,000)—

"(A) of alterations, repairs, and improvements on or in connection with an existing residence by the owner thereof, but

"(B) only of such items as substantially protect or improve the basic livability or energy efficiency of the property.

"(5) QUALIFIED REHABILITATION LOAN.—

"(A) IN GENERAL.—The term 'qualified rehabilitation loan' means any owner-financing provided in connection with—

"(i) a qualified rehabilitation, or

"(ii) the acquisition of a residence with respect to which there has been a qualified rehabilitation,

but only if the mortgagor to whom such financing is provided is the first resident of the residence after the completion of the rehabilitation.

"(B) QUALIFIED REHABILITATION.—For purposes of subparagraph (A), the term 'qualified rehabilitation' means any rehabilitation of a building if—

"(i) there is a period of at least 20 years between the date on which the building was first used and the date on which the physical work on such rehabilitation begins,

"(ii) in the rehabilitation process—

"(I) 50 percent or more of the existing external walls of such building are retained in place as external walls,

"(II) 75 percent or more of the existing external walls of such building are retained in place as internal or external walls, and

"(III) 75 percent or more of the existing internal structural framework of such building is retained in place, and

"(iii) the expenditures for such rehabilitation are 25 percent or more of the mortgagor's adjusted basis in the residence.

For purposes of clause (iii), the mortgagor's adjusted basis shall be determined as of the completion of the rehabilitation or, if later, the date on which the mortgagor acquires the residence.

"(6) DETERMINATIONS ON ACTUARIAL BASIS.—All determinations of yield, effective interest rates, and amounts required to be paid or credited to mortgagors or paid to the United States

under subsection (g) shall be made on an actuarial basis taking into account the present value of money.

"(7) SINGLE-FAMILY AND OWNER-OCCUPIED RESIDENCES INCLUDE CERTAIN RESIDENCES WITH 2 TO 4 UNITS.—Except for purposes of subsection (h)(2), the terms 'single-family' and 'owner-occupied', when used with respect to residences, include 2, 3, or 4 family residences—

"(A) one unit of which is occupied by the owner of the units, and

"(B) which were first occupied at least 5 years before the mortgage is executed.

"(8) COOPERATIVE HOUSING CORPORATIONS.—

"(A) IN GENERAL.—In the case of any cooperative housing corporation—

"(i) each dwelling unit shall be treated as if it were actually owned by the person entitled to occupy such dwelling unit by reason of his ownership of stock in the corporation, and

"(ii) any indebtedness of the corporation allocable to the dwelling unit shall be treated as if it were indebtedness of the shareholder entitled to occupy the dwelling unit.

"(B) ADJUSTMENT TO TARGETED AREA REQUIREMENT.—In the case of any issue to provide financing to a cooperative housing corporation with respect to cooperative housing not located in a targeted area, to the extent provided in regulations, such issue may be combined with 1 or more other issues for purposes of determining whether the requirements of subsection (h) are met.

"(C) COOPERATIVE HOUSING CORPORATION.—The term 'cooperative housing corporation' has the meaning given to such term by section 216(b)(1).

"(9) TREATMENT OF LIMITED EQUITY COOPERATIVE HOUSING.—

"(A) TREATMENT AS RESIDENTIAL RENTAL PROPERTY.—Except as provided in subparagraph (B), for purposes of this part—

"(i) any limited equity cooperative housing shall be treated as residential rental property and not as owner-occupied housing, and

"(ii) bonds issued to provide such housing shall be subject to the same requirements and limitations as bonds the proceeds of which are to be used to provide qualified residential rental projects (as defined in section 142(d)).

"(B) BONDS SUBJECT TO QUALIFIED MORTGAGE BOND TERMINATION DATE.—Subparagraph (A) shall not apply to any bond issued after the date specified in subsection (a)(1)(B).

"(C) LIMITED EQUITY COOPERATIVE HOUSING.—For purposes of this paragraph, the term 'limited equity cooperative housing' means any dwelling unit which a person is entitled to occupy by reason of his ownership of stock in a qualified cooperative housing corporation.

"(D) QUALIFIED COOPERATIVE HOUSING CORPORATION.—For purposes of this paragraph, the term 'qualified coopera-

tive housing corporation' means any cooperative housing corporation (as defined in section 216(b)(1)) if—

"(i) the consideration paid for stock held by any stockholder entitled to occupy any house or apartment in a building owned or leased by the corporation may not exceed the sum of—

"(I) the consideration paid for such stock by the first such stockholder, as adjusted by a cost-of-living adjustment determined by the Secretary,

"(II) payments made by any stockholder for improvements to such house or apartment, and

"(III) payments (other than amounts taken into account under subclause (I) or (II)) attributable to any stockholder to amortize the principal of the corporation's indebtedness arising from the acquisition or development of real property, including improvements thereof,

"(ii) the value of the corporation's assets (reduced by any corporate liabilities), to the extent such value exceeds the combined transfer values of the outstanding corporate stock, shall be used only for public benefit or charitable purposes, or directly to benefit the corporation itself, and shall not be used directly to benefit any stockholder, and

"(iii) at the time of issuance of the issue, such corporation makes an election under this paragraph.

"(E) EFFECT OF ELECTION.—If a cooperative housing corporation makes an election under this paragraph, section 216 shall not apply with respect to such corporation (or any successor thereof) during the qualified project period (as defined in section 142(d)(2)).

"(F) CORPORATION MUST CONTINUE TO BE QUALIFIED COOPERATIVE.—Subparagraph (A)(i) shall not apply to limited equity cooperative housing unless the cooperative housing corporation continues to be a qualified cooperative housing corporation at all times during the qualified project period (as defined in section 142(d)(2)).

"(G) ELECTION IRREVOCABLE.—Any election under this paragraph, once made, shall be irrevocable.

"(l) ADDITIONAL REQUIREMENTS FOR QUALIFIED VETERANS' MORTGAGE BONDS.—An issue meets the requirements of this subsection only if it meets the requirements of paragraphs (1), (2), and (3).

"(1) VETERANS TO WHOM FINANCING MAY BE PROVIDED.—An issue meets the requirements of this paragraph only if each mortgagor to whom financing is provided under the issue is a qualified veteran.

"(2) REQUIREMENT THAT STATE PROGRAM BE IN EFFECT BEFORE JUNE 22, 1984.—An issue meets the requirements of this paragraph only if it is a general obligation of a State which issued qualified veterans' mortgage bonds before June 22, 1984.

"(3) VOLUME LIMITATION.—

"(A) IN GENERAL.—An issue meets the requirements of this paragraph only if the aggregate amount of bonds issued pursuant thereto (when added to the aggregate

amount of qualified veterans' mortgage bonds previously issued by the State during the calendar year) does not exceed the State veterans limit for such calendar year.

"(B) STATE VETERANS LIMIT.—A State veterans limit for any calendar year is the amount equal to—

"(i) the aggregate amount of qualified veterans bonds issued by such State during the period beginning on January 1, 1979, and ending on June 22, 1984 (not including the amount of any qualified veterans bond issued by such State during the calendar year (or portion thereof) in such period for which the amount of such bonds so issued was the lowest), divided by

"(ii) the number (not to exceed 5) of calendar years after 1979 and before 1985 during which the State issued qualified veterans bonds (determined by only taking into account bonds issued on or before June 22, 1984).

"(C) TREATMENT OF REFUNDING ISSUES.—

"(i) IN GENERAL.—For purposes of subparagraph (A), the term 'qualified veterans' mortgage bond' shall not include any bond issued to refund another bond but only if the maturity date of the refunding bond is not later than the later of—

"(I) the maturity date of the bond to be refunded, or

"(II) the date 32 years after the date on which the refunded bond was issued (or in the case of a series of refundings, the date on which the original bond was issued).

The preceding sentence shall apply only to the extent that the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

"(ii) EXCEPTION FOR ADVANCE REFUNDING.—Clause (i) shall not apply to any bond issued to advance refund another bond.

"(4) QUALIFIED VETERAN.—For purposes of this subsection, the term 'qualified veteran' means any veteran—

"(A) who served on active duty at some time before January 1, 1977, and

"(B) who applied for the financing before the later of—

"(i) the date 30 years after the last date on which such veteran left active service, or

"(ii) January 31, 1985.

"(5) SPECIAL RULE FOR CERTAIN SHORT-TERM BONDS.—In the case of any bond—

"(A) which has a term of 1 year or less,

"(B) which is authorized to be issued under O.R.S. 407.435 (as in effect on the date of the enactment of this subsection), to provide financing for property taxes, and

"(C) which is redeemed at the end of such term,

the amount taken into account under this subsection with respect to such bond shall be $^{1}/_{15}$ *of its principal amount.*

"SEC. 144. QUALIFIED SMALL ISSUE BOND; QUALIFIED STUDENT LOAN BOND; QUALIFIED REDEVELOPMENT BOND.

"(a) QUALIFIED SMALL ISSUE BOND.—

"(1) IN GENERAL.—For purposes of this part, the term 'qualified small issue bond' means any bond issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and 95 percent or more of the net proceeds of which are to be used—

"(A) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or

"(B) to redeem part or all of a prior issue which was issued for purposes described in subparagraph (A) or this subparagraph.

"(2) CERTAIN PRIOR ISSUES TAKEN INTO ACCOUNT.—If—

"(A) the proceeds of 2 or more issues of bonds (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality),

"(B) the principal user of such facilities is or will be the same person or 2 or more related persons, and

"(C) but for this paragraph, paragraph (1) (or the corresponding provision of prior law) would apply to each such issue,

then, for purposes of paragraph (1), in determining the aggregate face amount of any later issue there shall be taken into account the aggregate face amount of tax-exempt bonds issued under all prior such issues and outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

"(3) RELATED PERSONS.—For purposes of this subsection, a person is a related person to another person if—

"(A) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), or

"(B) such persons are members of the same controlled group of corporations (as defined in section 1563(a), except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears therein).

"(4) $10,000,000 LIMIT IN CERTAIN CASES.—

"(A) IN GENERAL.—At the election of the issuer with respect to any issue, this subsection shall be applied—

"(i) by substituting '$10,000,000' for '$1,000,000' in paragraph (1), and

"(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in paragraph (2), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (B) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of the proceeds of outstanding tax-exempt issues to which paragraph (1)

(or the corresponding provision of prior law) applied), as if the aggregate amount of such capital expenditures constituted the face amount of a prior outstanding issue described in paragraph (2).

"(B) Facilities taken into account.—For purposes of subparagraph (A)(ii), the facilities described in this subparagraph are facilities—

"(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

"(ii) the principal user of which is or will be the same person or 2 or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

"(C) Certain capital expenditures not taken into account.—For purposes of subparagraph (A)(ii), any capital expenditure—

"(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

"(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance,

"(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed $1,000,000), or

"(iv) described in clause (i) or (ii) of section 41(b)(2)(A) for which a deduction was allowed under section 174(a),

shall not be taken into account.

"(D) Limitation on loss of tax exemption.—In applying subparagraph (A)(ii) with respect to capital expenditures made after the date of any issue, no bond issued as a part of such issue shall cease to be treated as a qualified small issue bond by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

"(E) Certain refinancing issues.—In the case of any issue described in paragraph (1)(B), an election may be made under subparagraph (A) of this paragraph only if all of the prior issues being redeemed are issues to which paragraph (1) (or the corresponding provision of prior law) applied. In applying subparagraph (A)(ii) with respect to such a refinancing issue, capital expenditures shall be taken into account only for purposes of determining whether the prior issues being redeemed qualified (and would have continued *to qualify) under paragraph (1) (or the corresponding provision of prior law).*

“(F) AGGREGATE AMOUNT OF CAPITAL EXPENDITURES WHERE THERE IS URBAN DEVELOPMENT ACTION GRANT.—In the case of any issue 95 percent or more of the net proceeds of which are to be used to provide facilities with respect to which an urban development action grant has been made under section 119 of the Housing and Community Development Act of 1974, capital expenditures of not to exceed $10,000,000 shall not be taken into account for purposes of applying subparagraph (A)(ii).

“(5) ISSUES FOR RESIDENTIAL PURPOSES.—This subsection shall not apply to any bond issued as part of an issue 5 percent or more of the net proceeds of which are to be used directly or indirectly to provide residential real property for family units.

“(6) LIMITATIONS ON TREATMENT OF BONDS AS PART OF THE SAME ISSUE.—

“(A) IN GENERAL.—For purposes of this subsection, separate lots of bonds which (but for this subparagraph) would be treated as part of the same issue shall be treated as separate issues unless the proceeds of such lots are to be used with respect to 2 or more facilities—

“(i) which are located in more than 1 State, or

“(ii) which have, or will have, as the same principal user the same person or related persons.

“(B) FRANCHISES.—For purposes of subparagraph (A), a person (other than a governmental unit) shall be considered a principal user of a facility if such person (or a group of related persons which includes such person)—

“(i) guarantees, arranges, participates in, or assists with the issuance (or pays any portion of the cost of issuance) of any bond the proceeds of which are to be used to finance or refinance such facility, and

“(ii) provides any property, or any franchise, trademark, or trade name (within the meaning of section 1253), which is to be used in connection with such facility.

“(7) SUBSECTION NOT TO APPLY IF BONDS ISSUED WITH CERTAIN OTHER TAX-EXEMPT BONDS.—This subsection shall not apply to any bond issued as part of an issue (other than an issue to which paragraph (4) applies) if the interest on any other bond which is part of such issue is excluded from gross income under any provision of law other than this subsection.

“(8) RESTRICTIONS ON FINANCING CERTAIN FACILITIES.—This subsection shall not apply to an issue if—

“(A) more than 25 percent of the net proceeds of the issue are to be used to provide a facility the primary purpose of which is one of the following: retail food and beverage services, automobile sales or service, or the provision of recreation or entertainment; or

“(B) any portion of the proceeds of the issue is to be used to provide the following: any private or commercial golf course, country club, massage parlor, tennis club, skating facility (including roller skating, skateboard, and ice skat-

ing), racquet sports facility (including any handball or racquetball court), hot tub facility, suntan facility, or racetrack.

"(9) AGGREGATION OF ISSUES WITH RESPECT TO SINGLE PROJECT.—For purposes of this subsection, 2 or more issues part or all of the net proceeds of which are to be used with respect to a single building, an enclosed shopping mall, or a strip of offices, stores, or warehouses using substantial common facilities shall be treated as 1 issue (and any person who is a principal user with respect to any of such issues shall be treated as a principal user with respect to the aggregated issue).

"(10) AGGREGATE LIMIT PER TAXPAYER.—

"(A) IN GENERAL.—This subsection shall not apply to any issue if the aggregate authorized face amount of such issue allocated to any test-period beneficiary (when increased by the outstanding tax-exempt facility-related bonds of such beneficiary) exceeds $40,000,000.

"(B) OUTSTANDING TAX-EXEMPT FACILITY-RELATED BONDS.—

"(i) IN GENERAL.—For purposes of applying subparagraph (A) with respect to any issue, the outstanding tax-exempt facility-related bonds of any person who is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in clause (ii)—

"(I) which are allocated to such beneficiary, and

"(II) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

"(ii) BONDS TAKEN INTO ACCOUNT.—For purposes of clause (i), the bonds referred to in this clause are—

"(I) exempt facility bonds, qualified small issue bonds, and qualified redevelopment bonds, and

"(II) industrial development bonds (as defined in section 103(b)(2), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) to which section 141(a) does not apply.

"(C) ALLOCATION OF FACE AMOUNT OF ISSUE.—

"(i) IN GENERAL.—Except as otherwise provided in regulations, the portion of the face amount of an issue allocated to any test-period beneficiary of a facility financed by the proceeds of such issue (other than an owner of such facility) is an amount which bears the same relationship to the entire face amount of such issue as the portion of such facility used by such beneficiary bears to the entire facility.

"(ii) OWNERS.—Except as otherwise provided in regulations, the portion of the face amount of an issue allocated to any test-period beneficiary who is an owner of a facility financed by the proceeds of such issue is an amount which bears the same relationship to the entire face amount of such issue as the portion of such facili-

ty owned by such beneficiary bears to the entire facility.

"(D) Test-period beneficiary.—For purposes of this paragraph, except as provided in regulations, the term 'test-period beneficiary' means any person who is an owner or a principal user of facilities being financed by the issue at any time during the 3-year period beginning on the later of—

"(i) the date such facilities were placed in service, or

"(ii) the date of issue.

"(E) Treatment of related persons.—For purposes of this paragraph, all persons who are related (within the meaning of paragraph (3)) to each other shall be treated as 1 person.

"(11) Limitation on acquisition of depreciable farm property.—

"(A) In general.—This subsection shall not apply to any issue if more than $250,000 of the net proceeds of such issue are to be used to provide depreciable farm property with respect to which the principal user is or will be the same person or 2 or more related persons.

"(B) Depreciable farm property.—For purposes of this paragraph, the term 'depreciable farm property' means property of a character subject to the allowance for depreciation which is to be used in a trade or business of farming.

"(C) Prior issues taken into account.—In determining the amount of proceeds of an issue to be used as described in subparagraph (A), there shall be taken into account the aggregate amount of each prior issue to which paragraph (1) (or the corresponding provisions of prior law) applied which were or will be so used.

"(12) Termination dates.—

"(A) In general.—This subsection shall not apply to—

"(i) any bond (other than a bond described in clause (ii)) issued after December 31, 1986, or

"(ii) any bond issued to refund a bond issued on or before such date unless—

"(I) the refunding bond has a maturity date not later than the maturity date of the refunded bond,

"(II) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond,

"(III) the interest rate on the refunding bond is lower than the interest rate on the refunded bond, and

"(IV) the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond.

"(B) Bonds issued to finance manufacturing facilities and farm property.—In the case of any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide—

"(i) any manufacturing facility, or

"(ii) any land or property in accordance with section 147(c)(2),

subparagraph (A) shall be applied by substituting '1989' for '1986'.

"(C) MANUFACTURING FACILITY.—For purposes of this paragraph, the term 'manufacturing facility' means any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). A rule similar to the rule of section 142(b)(2) shall apply for purposes of the preceding sentence.

"(b) QUALIFIED STUDENT LOAN BOND.—For purposes of this part—

"(1) IN GENERAL.—The term 'qualified student loan bond' means any bond issued as part of an issue the applicable percentage or more of the net proceeds of which are to be used directly or indirectly to make or finance student loans under—

"(A) a program of general application to which the Higher Education Act of 1965 applies if—

"(i) limitations are imposed under the program on—

"(I) the maximum amount of loans outstanding to any student, and

"(II) the maximum rate of interest payable on any loan,

"(ii) the loans are directly or indirectly guaranteed by the Federal Government,

"(iii) the financing of loans under the program is not limited by Federal law to the proceeds of tax-exempt bonds, and

"(iv) special allowance payments under section 438 of the Higher Education Act of 1965—

"(I) are authorized to be paid with respect to loans made under the program, or

"(II) would be authorized to be made with respect to loans under the program if such loans were not financed with the proceeds of tax-exempt bonds, or

"(B) a program of general application approved by the State to which part B of title IV of the Higher Education Act of 1965 (relating to guaranteed student loans) does not apply if no loan under such program exceeds the difference between the total cost of attendance and other forms of student assistance (not including loans pursuant to section 428B(a)(1) of such Act (relating to parent loans) or subpart I of part C of title VII of the Public Health Service Act (relating to student assistance)) for which the student borrower may be eligible a bond issued as part of an issue shall be treated as a qualified student loan bond only if no bond which is part of such issue meets the private business tests of paragraphs (1) and (2) of section 141(b).

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the term 'applicable percentage' means—

"(A) 90 percent in the case of the program described in paragraph (1)(A), and

"(B) 95 percent in the case of the program described in paragraph (1)(B).

"(3) STUDENT BORROWERS MUST BE RESIDENTS OF ISSUING STATE, ETC.—A student loan shall be treated as being made or financed under a program described in paragraph (1) with respect to an issue only if the student is—

"(A) a resident of the State from which the volume cap under section 146 for such loan was derived, or

"(B) enrolled at an educational institution located in such State.

"(4) DISCRIMINATION ON BASIS OF SCHOOL LOCATION NOT PERMITTED.—A program shall not be treated as described in paragraph (1)(A) if such program discriminates on the basis of the location (in the United States) of the educational institution in which the student is enrolled.

"(c) QUALIFIED REDEVELOPMENT BOND.—For purposes of this part—

"(1) IN GENERAL.—The term 'qualified redevelopment bond' means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used for 1 or more redevelopment purposes in any designated blighted area.

"(2) ADDITIONAL REQUIREMENTS.—A bond shall not be treated as a qualified redevelopment bond unless—

"(A) the issue described in paragraph (1) is issued pursuant to—

"(i) a State law which authorizes the issuance of such bonds for redevelopment purposes in blighted areas, and

"(ii) a redevelopment plan which is adopted before such issuance by the governing body described in paragraph (4)(A) with respect to the designated blighted area,

"(B)(i) the payment of the principal and interest on such issue is primarily secured by taxes of general applicability imposed by a general purpose governmental unit, or

"(ii) any increase in real property tax revenues (attributable to increases in assessed value) by reason of the carrying out of such purposes in such area is reserved exclusively for debt service on such issue (and similar issues) to the extent such increase does not exceed such debt service,

"(C) each interest in real property located in such area—

"(i) which is acquired by a governmental unit with the proceeds of the issue, and

"(ii) which is transferred to a person other than a governmental unit,

is transferred for fair market value,

"(D) the financed area with respect to such issue meets the no additional charge requirements of paragraph (5), and

"(E) the use of the proceeds of the issue meets the requirements of paragraph (6).

"(3) REDEVELOPMENT PURPOSES.—For purposes of paragraph (1)—

"(A) IN GENERAL.—The term 'redevelopment purposes' means, with respect to any designated blighted area—

"(i) the acquisition (by a governmental unit having the power to exercise eminent domain) of real property located in such area,

"(ii) the clearing and preparation for redevelopment of land in such area which was acquired by such governmental unit,

"(iii) the rehabilitation of real property located in such area which was acquired by such governmental unit, and

"(iv) the relocation of occupants of such real property.

"(B) NEW CONSTRUCTION NOT PERMITTED.—The term 'redevelopment purposes' does not include the construction (other than the rehabilitation) of any property or the enlargement of an existing building.

"(4) DESIGNATED BLIGHTED AREA.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'designated blighted area' means any blighted area designated by the governing body of a local general purpose governmental unit in the jurisdiction of which such area is located.

"(B) BLIGHTED AREA.—The term 'blighted area' means any area which the governing body described in subparagraph (A) determines to be a blighted area on the basis of the substantial presence of factors such as excessive vacant land on which structures were previously located, abandoned or vacant buildings, substandard structures, vacancies, and delinquencies in payment of real property taxes.

"(C) DESIGNATED AREAS MAY NOT EXCEED 20 PERCENT OF TOTAL ASSESSED VALUE OF REAL PROPERTY IN GOVERNMENT'S JURISDICTION.—

"(i) IN GENERAL.—An area may be designated by a governmental unit as a blighted area only if the designation percentage with respect to such area, when added to the designation percentages of all other designated blighted areas within the jurisdiction of such governmental unit, does not exceed 20 percent.

"(ii) DESIGNATION PERCENTAGE.—For purposes of this subparagraph, the term 'designation percentage' means, with respect to any area, the percentage (determined at the time such area is designated) which the assessed value of real property located in such area is of the total assessed value of all real property located within the jurisdiction of the governmental unit which designated such area.

"(iii) EXCEPTION WHERE BONDS NOT OUTSTANDING.—The designation percentage of a previously designated blighted area shall not be taken into account under clause (i) if no qualified redevelopment bond (or similar bond) is or will be outstanding with respect to such area.

"(D) MINIMUM DESIGNATED AREA.—

"(i) In general.—Except as provided in clause (ii), an area shall not be treated as a designated blighted area for purposes of this subsection unless such area is contiguous and compact and its area equals or exceeds 100 acres.

"(ii) 10-acre minimum in certain cases.—Clause (i) shall be applied by substituting '10 acres' for '100 acres' if not more than 25 percent of the financed area is to be provided (pursuant to the issue and all other such issues) to 1 person. For purposes of the preceding sentence, all related persons (as defined in subsection (a)(3)) shall be treated as 1 person. For purposes of this clause, an area provided to a developer on a short-term interim basis shall not be treated as provided to such developer.

"(5) No additional charge requirements.—The financed area with respect to any issue meets the requirements of this paragraph if, while any bond which is part of such issue is outstanding—

"(A) no owner or user of property located in the financed area is subject to a charge or fee which similarly situated owners or users of comparable property located outside such area are not subject, and

"(B) the assessment method or rate of real property taxes with respect to property located in the financed area does not differ from the assessment method or rate of real property taxes with respect to comparable property located outside such area.

For purposes of the preceding sentence, the term 'comparable property' means property which is of the same type as the property to which it is being compared and which is located within the jurisdiction of the designating governmental unit.

"(6) Use of proceeds requirements.—The use of the proceeds of an issue meets the requirements of this paragraph if—

"(A) not more than 25 percent of the net proceeds of such issue are to be used to provide (including the provision of land for) facilities described in subsection (a)(8) or section 147(e), and

"(B) no portion of the proceeds of such issue is to be used to provide (including the provision of land for) any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

"(7) Financed area.—For purposes of this subsection, the term 'financed area' means, with respect to any issue, the portion of the designated blighted area with respect to which the proceeds of such issue are to be used.

"(8) Restriction on acquisition of land not to apply.—Section 147(c) (other than paragraphs (1)(B) and (2) thereof) shall not apply to any qualified redevelopment bond.

"SEC. 145. QUALIFIED 501(c)(3) BOND.

"(a) IN GENERAL.—For purposes of this part, except as otherwise provided in this section, the term 'qualified 501(c)(3) bond' means any private activity bond issued as part of an issue if—

"(1) all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and

"(2) such bond would not be a private activity bond if—

"(A) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513(a), and

"(B) paragraphs (1) and (2) of section 141(b) were applied by substituting '5 percent' for '10 percent' each place it appears and by substituting 'net proceeds' for 'proceeds' each place it appears..

"(b) $150,000,000 LIMITATION ON BONDS OTHER THAN HOSPITAL BONDS.—

"(1) IN GENERAL.—A bond (other than a qualified hospital bond) shall not be treated as a qualified 501(c)(3) bond if the aggregate authorized face amount of the issue (of which such bond is a part) allocated to any 501(c)(3) organization which is a test-period beneficiary (when increased by the outstanding tax-exempt nonhospital bonds of such organization) exceeds $150,000,000.

"(2) OUTSTANDING TAX-EXEMPT NONHOSPITAL BONDS.—

"(A) IN GENERAL.—For purposes of applying paragraph (1) with respect to any issue, the outstanding tax-exempt nonhospital bonds of any organization which is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in subparagraph (B)—

"(i) which are allocated to such organization, and

"(ii) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

"(B) BONDS TAKEN INTO ACCOUNT.—For purposes of subparagraph (A), the bonds referred to in this subparagraph are—

"(i) any qualified 501(c)(3) bond other than a qualified hospital bond, and

"(ii) any bond to which section 141(a) does not apply if—

"(I) such bond would have been an industrial development bond (as defined in section 103(b), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) if 501(c)(3) organizations were not exempt persons, and

"(II) such bond was not described in paragraph (4), (5), or (6) of such section 103(b) (as in effect on the date such bond was issued).

"(C) ONLY NONHOSPITAL PORTION OF BONDS TAKEN INTO ACCOUNT.—

"(i) In general.—A bond shall be taken into account under subparagraph (B)(ii) only to the extent that the proceeds of the issue of which such bond is a part are not used with respect to a hospital.

"(ii) Special rule.—If 90 percent or more of the net proceeds of an issue are used with respect to a hospital, no bond which is part of such issue shall be taken into account under subparagraph (B)(ii).

"(3) Aggregation rule.—For purposes of this subsection, 2 or more organizations under common management or control shall be treated as 1 organization.

"(4) Allocation of face amount of issue; test-period beneficiary.—Rules similar to the rules of subparagraphs (C) and (D) of section 144(a)(10) shall apply for purposes of this subsection.

"(c) Qualified Hospital Bond.—For purposes of this section, the term 'qualified hospital bond' means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used with respect to a hospital.

"(d) Election Out.—This section shall not apply to an issue if—

"(1) the issue elects not to have this section apply to such issue, and

"(2) such issue is an issue of exempt facility bonds, or qualified redevelopment bonds, to which section 146 applies.

"SEC. 146. VOLUME CAP.

"(a) General Rule.—A private activity bond issued as part of an issue meets the requirements of this section if the aggregate face amount of the private activity bonds issued pursuant to such issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed such authority's volume cap for such calendar year.

"(b) Volume Cap for State Agencies.—For purposes of this section—

"(1) In general.—The volume cap for any agency of the State authorized to issue tax-exempt private activity bonds for any calendar year shall be 50 percent of the State ceiling for such calendar year.

"(2) Special rule where state has more than 1 agency.—If more than 1 agency of the State is authorized to issue tax-exempt private activity bonds, all such agencies shall be treated as a single agency.

"(c) Volume Cap for Other Issuers.—For purposes of this section—

"(1) In general.—The volume cap for any issuing authority (other than a State agency) for any calendar year shall be an amount which bears the same ratio to 50 percent of the State ceiling for such calendar year as—

"(A) the population of the jurisdiction of such issuing authority, bears to

"(B) the population of the entire State.

"(2) Overlapping jurisdictions.—For purposes of paragraph (1)(A), if an area is within the jurisdiction of 2 or more govern-

mental units, such area shall be treated as only within the jurisdiction of the unit having jurisdiction over the smallest geographical area unless such unit agrees to surrender all or part of such jurisdiction for such calendar year to the unit with overlapping jurisdiction which has the next smallest geographical area.

"(d) STATE CEILING.—For purposes of this section—

"(1) IN GENERAL.—The State ceiling applicable to any State for any calendar year shall be the greater of—

"(A) an amount equal to $75 multiplied by the State population, or

"(B) $250,000,000.

Subparagraph (B) shall not apply to any possession of the United States.

"(2) ADJUSTMENT AFTER 1987.—In the case of calendar years after 1987, paragraph (1) shall be applied by substituting—

"(A) '$50' for '$75', and

"(B) '$150,000,000' for '$250,000,000'.

"(3) SPECIAL RULE FOR STATES WITH CONSTITUTIONAL HOME RULE CITIES.—For purposes of this section—

"(A) IN GENERAL.—The volume cap for any constitutional home rule city for any calendar year shall be determined under paragraph (1) of subsection (c) by substituting '100 percent' for '50 percent'.

"(B) COORDINATION WITH OTHER ALLOCATIONS.—In the case of any State which contains 1 or more constitutional home rule cities, for purposes of applying subsections (b) and (c) with respect to issuing authorities in such State other than constitutional home rule cities, the State ceiling for any calendar year shall be reduced by the aggregate volume caps determined for such year for all constitutional home rule cities in such State.

"(C) CONSTITUTIONAL HOME RULE CITY.—For purposes of this section, the term 'constitutional home rule city' means, with respect to any calendar year, any political subdivision of a State which, under a State constitution which was adopted in 1970 and effective on July 1, 1971, had home rule powers on the 1st day of the calendar year.

"(4) SPECIAL RULE FOR POSSESSIONS WITH POPULATIONS OF LESS THAN THE POPULATION OF THE LEAST POPULOUS STATE.—

"(A) IN GENERAL.—If the population of any possession of the United States for any calendar year is less than the population of the least populous State (other than a possession) for such calendar year, the limitation under paragraph (1)(A) shall not be less than the amount determined under subparagraph (B) for such calendar year.

"(B) LIMITATION.—The limitation determined under this subparagraph, with respect a possession, for any calendar year is an amount equal to the product of—

"(i) the fraction—

"(I) the numerator of which is the amount applicable under paragraph (1)(B) for such calendar year, and

"(II) the denominator of which is the State population of the least populous State (other than a possession) for such calendar year, and

"(ii) the population of such possession for such calendar year.

"(e) STATE MAY PROVIDE FOR DIFFERENT ALLOCATION.—For purposes of this section—

"(1) IN GENERAL.—Except as provided in paragraph (3), a State may, by law provide a different formula for allocating the State ceiling among the governmental units (or other authorities) in such State having authority to issue tax-exempt private activity bonds.

"(2) INTERIM AUTHORITY FOR GOVERNOR.—

"(A) IN GENERAL.—Except as otherwise provided in paragraph (3), the Governor of any State may proclaim a different formula for allocating the State ceiling among the governmental units (or other authorities) in such State having authority to issue private activity bonds.

"(B) TERMINATION OF AUTHORITY.—The authority provided in subparagraph (A) shall not apply to bonds issued after the earlier of—

"(i) the last day of the 1st calendar year after 1986 during which the legislature of the State met in regular session, or

"(ii) the effective date of any State legislation with respect to the allocation of the State ceiling.

"(3) STATE MAY NOT ALTER ALLOCATION TO CONSTITUTIONAL HOME RULE CITIES.—Except as otherwise provided in a State constitutional amendment (or law changing the home rule provision adopted in the manner provided by the State constitution), the authority provided in this subsection shall not apply to that portion of the State ceiling which is allocated to any constitutional home rule city in the State unless such city agrees to such different allocation.

"(f) ELECTIVE CARRYFORWARD OF UNUSED LIMITATION FOR SPECIFIED PURPOSE.—

"(1) IN GENERAL.—If—

"(A) an issuing authority's volume cap for any calendar year after 1985, exceeds

"(B) the aggregate amount of tax-exempt private activity bonds issued during such calendar year by such authority, such authority may elect to treat all (or any portion) of such excess as a carryforward for 1 or more carryforward purposes.

"(2) ELECTION MUST IDENTIFY PURPOSE.—In any election under paragraph (1), the issuing authority shall—

"(A) identify the purpose for which the carryforward is elected, and

"(B) specify the portion of the excess described in paragraph (1) which is to be a carryforward for each such purpose.

"(3) USE OF CARRYFORWARD.—

"(A) IN GENERAL.—If any issuing authority elects a carryforward under paragraph (1) with respect to any carryforward purpose, any private activity bonds issued by such au-

thority with respect to such purpose during the 3 calendar years following the calendar year in which the carryforward arose shall not be taken into account under subsection (a) to the extent the amount of such bonds does not exceed the amount of the carryforward elected for such purpose.

"(B) ORDER IN WHICH CARRYFORWARD USED.—Carryforwards elected with respect to any purpose shall be used in the order of the calendar years in which they arose.

"(4) ELECTION.—Any election under this paragraph (and any identification or specification contained therein), once made, shall be irrevocable.

"(5) CARRYFORWARD PURPOSE.—The term 'carryforward purpose' means—

"(A) the purpose of issuing bonds referred to in one of the clauses of section 141(d)(1)(A),

"(B) the purpose of issuing qualified mortgage bonds or mortgage credit certificates,

"(C) the purpose of issuing qualified student loan bonds, and

"(D) the purpose of issuing qualified redevelopment bonds.

"(g) EXCEPTION FOR CERTAIN BONDS.—Only for purposes of this section, the term 'private activity bond' shall not include—

"(1) any qualified veterans' mortgage bond,

"(2) any qualified 501(c)(3) bond, and

"(3) any exempt facility bond issued as part of an issue described in paragraph (1) or (2) of section 142(a) (relating to airports and docks and wharves).

"(h) EXCEPTION FOR GOVERNMENT-OWNED SOLID WASTE DISPOSAL FACILITIES.—

"(1) IN GENERAL.—Only for purposes of this section, the term 'private activity bond' shall not include any exempt facility bond described in section 142(a)(6) which is issued as part of an issue if all of the property to be financed by the net proceeds of such issue is to be owned by a governmental unit.

"(2) SAFE HARBOR FOR DETERMINATION OF GOVERNMENT OWNERSHIP.—In determining ownership for purposes of paragraph (1), section 142(b)(1)(B) shall apply, except that a lease term shall be treated as satisfying clause (ii) thereof if it is not more than 20 years.

"(i) TREATMENT OF REFUNDING ISSUES.—For purposes of the volume cap imposed by this section—

"(1) IN GENERAL.—The term 'private activity bond' shall not include any bond which is issued to refund another bond to the extent that the amount of such bond does not exceed the outstanding amount of the refunded bond.

"(2) SPECIAL RULES FOR STUDENT LOAN BONDS.—In the case of any qualified student loan bond, paragraph (1) shall apply only if the maturity date of the refunding bond is not later than the later of—

"(A) the maturity date of the bond to be refunded, or

"(B) the date 17 years after the date on which the refunded bond was issued (or in the case of a series of refundings, the date on which the original bond was issued).

"(3) SPECIAL RULES FOR QUALIFIED MORTGAGE BONDS.—In the case of any qualified mortgage bond, paragraph (1) shall apply only if the maturity date of the refunding bond is not later than the later of—

"(A) the maturity date of the bond to be refunded, or

"(B) the date 32 years after the date on which the refunded bond was issued (or in the case of a series of refundings, the date on which the original bond was issued).

"(4) EXCEPTION FOR ADVANCE REFUNDING.—This subsection shall not apply to any bond issued to advance refund another bond.

"(j) POPULATION.—For purposes of this section, determinations of the population of any State (or issuing authority) shall be made with respect to any calendar year on the basis of the most recent census estimate of the resident population of such State (or issuing authority) released by the Bureau of Census before the beginning of such calendar year.

"(k) FACILITY MUST BE LOCATED WITHIN STATE.—

"(1) IN GENERAL.—Except as provided in paragraph (2), no portion of the State ceiling applicable to any State for any calendar year may be used with respect to financing for a facility located outside such State.

"(2) EXCEPTION FOR CERTAIN FACILITIES WHERE STATE WILL GET PROPORTIONATE SHARE OF BENEFITS.—Paragraph (1) shall not apply to any exempt facility bond described in paragraph (4), (5), (6), or (10) of section 142(a) if the issuer establishes that the State's share of the use of the facility (or its output) will equal or exceed the State's share of the private activity bonds issued to finance the facility.

"(l) ISSUER OF QUALIFIED SCHOLARSHIP FUNDING BONDS.—In the case of a qualified scholarship funding bond, such bond shall be treated for purposes of this section as issued by a State or local issuing authority (whichever is appropriate).

"(m) TREATMENT OF AMOUNTS ALLOCATED TO PRIVATE ACTIVITY PORTION OF GOVERNMENT USE BONDS.—

"(1) IN GENERAL.—The volume cap of an issuer shall be reduced by the amount allocated by the issuer to an issue under section 141(b)(5).

"(2) ADVANCE REFUNDINGS.—Except as otherwise provided by the Secretary, any advance refunding of any part of an issue to which an amount was allocated under section 141(b)(5) (or would have been allocated if such section applied to such issue) shall be taken into account under this section to the extent of the amount of the volume cap which was (or would have been) so allocated.

"(n) REDUCTION FOR MORTGAGE CREDIT CERTIFICATES, ETC.—The volume cap of any issuing authority for any calendar year shall be reduced by the sum of—

"(1) the amount of qualified mortgage bonds which such authority elects not to issue under section 25(c)(2)(A)(ii) during such year, plus

"(2) the amount of any reduction in such ceiling under section 25(f) applicable to such authority for such year.

"SEC. 147. OTHER REQUIREMENTS APPLICABLE TO CERTAIN PRIVATE ACTIVITY BONDS.

"(a) SUBSTANTIAL USER REQUIREMENT.—

"(1) IN GENERAL.—Except as provided in subsection (h), a private activity bond shall not be a qualified bond for any period during which it is held by a person who is a substantial user of the facilities or by a related person of such a substantial user.

"(2) RELATED PERSON.—For purposes of paragraph (1), the following shall be treated as related persons—

"(A) 2 or more persons if the relationship between such persons would result in a disallowance of losses under section 267 or 707(b),

"(B) 2 or more persons which are members of the same controlled group of corporations (as defined in section 1563(a), except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears therein),

"(C) a partnership and each of its partners (and their spouses and minor children), and

"(D) an S corporation and each of its shareholders (and their spouses and minor children).

"(b) MATURITY MAY NOT EXCEED 120 PERCENT OF ECONOMIC LIFE.—

"(1) GENERAL RULE.—Except as provided in subsection (h), a private activity bond shall not be a qualified bond if it is issued as part of an issue and—

"(A) the average maturity of the bonds issued as part of such issue, exceeds

"(B) 120 percent of the average reasonably expected economic life of the facilities being financed with the net proceeds of such issue.

"(2) DETERMINATION OF AVERAGES.—For purposes of paragraph (1)—

"(A) the average maturity of any issue shall be determined by taking into account the respective issue prices of the bonds issued as part of such issue, and

"(B) the average reasonably expected economic life of the facilities being financed with any issue shall be determined by taking into account the respective cost of such facilities.

"(3) SPECIAL RULES.—

"(A) DETERMINATION OF ECONOMIC LIFE.—For purposes of this subsection, the reasonably expected economic life of any facility shall be determined as of the later of—

"(i) the date on which the bonds are issued, or

"(ii) the date on which the facility is placed in service (or expected to be placed in service).

"(B) TREATMENT OF LAND.—

"(i) LAND NOT TAKEN INTO ACCOUNT.—Except as provided in clause (ii), land shall not be taken into account under paragraph (1)(B).

"(ii) ISSUES WHERE 25 PERCENT OR MORE OF PROCEEDS USED TO FINANCE LAND.—If 25 percent or more of

the net proceeds of any issue is to be used to finance land, such land shall be taken into account under paragraph (1)(B) and shall be treated as having an economic life of 30 years.

"(4) Special rule for pooled financing of 501(c)(3) organization.—

"(A) In general.—At the election of the issuer, a qualified 501(c)(3) bond shall be treated as meeting the requirements of paragraph (1) if such bond meets the requirements of subparagraph (B).

"(B) Requirements.—A qualified 501(c)(3) bond meets the requirements of this subparagraph if—

"(i) 95 percent or more of the net proceeds of the issue of which such bond is a part are to be used to make or finance loans to 2 or more 501(c)(3) organizations or governmental units for acquisition of property to be used by such organizations,

"(ii) each loan described in clause (i) satisfies the requirements of paragraph (1) (determined by treating each loan as a separate issue),

"(iii) before such bond is issued, a demand survey was conducted which shows a demand for financing greater than an amount equal to 120 percent of the lendable proceeds of such issue, and

"(iv) 95 percent or more of the net proceeds of such issue are to be loaned to 501(c)(3) organizations or governmental units within 1 year of issuance and, to the extent there are any unspent proceeds after such 1-year period, bonds issued as part of such issue are to be redeemed as soon as possible thereafter (and in no event later than 18 months after issuance).

A bond shall not meet the requirements of this subparagraph if the maturity date of any bond issued as part of such issue is more than 30 years after the date on which the bond was issued (or, in the case of a refunding or series of refundings, the date on which the original bond was issued).

"(5) Special rule for certain FHA insured loans.—Paragraph (1) shall not apply to any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to finance mortgage loans insured under FHA 242 or under a similar Federal Housing Administration program (as in effect on the date of the enactment of the Tax Reform Act of 1986) where the loan term approved by such Administration plus the maximum maturity of debentures which could be issued by such Administration in satisfaction of its obligations exceeds the term permitted under paragraph (1).

"(c) Limitation on Use for Land Acquisition.—

"(1) In general.—Except as provided in subsection (h), a private activity bond shall not be a qualified bond if—

"(A) it is issued as part of an issue and 25 percent or more of the net proceeds of such issue are to be used (directly or indirectly) for the acquisition of land (or an interest therein), or

"(B) any portion of the proceeds of such issue is to be used (directly or indirectly) for the acquisition of land (or an interest therein) to be used for farming purposes.

"(2) Exception for first-time farmers.—

"(A) In general.—If the requirements of subparagraph (B) are met with respect to any land, paragraph (1) shall not apply to such land, and subsection (d) shall not apply to property to be used thereon farming purposes, but only to the extent of expenditures (financed with the proceeds of the issue) not in excess of $250,000.

"(B) Acquisition by first-time farmers.—The requirements of this subparagraph are met with respect to any land if—

"(i) such land is to be used for farming purposes, and

"(ii) such land is to be acquired by an individual who is a first-time farmer, who will be the principal user of such land, and who will materially and substantially participate on the farm of which such land is a part in the operation of such farm.

"(C) First-time farmer.—For purposes of this paragraph—

"(i) In general.—The term 'first-time farmer' means any individual if such individual—

"(I) has not at any time had any direct or indirect ownership interest in substantial farmland in the operation of which such individual materially participated, and

"(II) has not received financing under this paragraph in an amount which, when added to the financing to be provided under this paragraph, exceeds $250,000.

"(ii) Aggregation rules.—Any ownership or material participation, or financing received, by an individual's spouse or minor child shall be treated as ownership and material participation, or financing received, by the individual.

"(iii) Insolvent farmer.—For purposes of clause (i), farmland which was previously owned by the individual and was disposed of while such individual was insolvent shall be disregarded if section 108 applied to indebtedness with respect to such farmland.

"(D) Farm.—For purposes of this paragraph, the term 'farm' has the meaning given such term by section 6420(c)(2).

"(E) Substantial farmland.—For purposes of this paragraph, the term 'substantial farmland' means any parcel of land unless—

"(i) such parcel is smaller than 15 percent of the median size of a farm in the county in which such parcel is located, and

"(ii) the fair market value of the land does not at any time while held by the individual exceed $125,000.

"(F) Used equipment limitation.—For purposes of this paragraph, in no event may the amount of financing pro-

vided by reason of this paragraph to a first-time farmer for personal property—

"(i) of a character subject to the allowance for depreciation,

"(ii) the original use of which does not begin with such farmer, and

"(iii) which is to be used for farming purposes,

exceed $62,500. A rule similar to the rule of subparagraph (C)(ii) shall apply for purposes of the preceding sentence.

"(3) EXCEPTION FOR CERTAIN LAND ACQUIRED FOR ENVIRONMENTAL PURPOSES, ETC.—Any land acquired by a governmental unit (or issuing authority) in connection with an airport, mass commuting facility, dock, or wharf shall not be taken into account under paragraph (1) if—

"(A) such land is acquired for noise abatement or wetland preservation, or for future use as an airport, mass commuting facility, dock, or wharf, and

"(B) there is not other significant use of such land.

"(d) ACQUISITION OF EXISTING PROPERTY NOT PERMITTED.—

"(1) IN GENERAL.—Except as provided in subsection (h), a private activity bond shall not be a qualified bond if issued as part of an issue and any portion of the net proceeds of such issue is to be used for the acquisition of any property (or an interest therein) unless the 1st use of such property is pursuant to such acquisition.

"(2) EXCEPTION FOR CERTAIN REHABILITATIONS.—Paragraph (1) shall not apply with respect to any building (and the equipment therefor) if—

"(A) the rehabilitation expenditures with respect to such building, equal or exceed

"(B) 15 percent of the portion of the cost of acquiring such building (and equipment) financed with the net proceeds of the issue.

A rule similar to the rule of the preceding sentence shall apply in the case of structures other than a building except that subparagraph (B) shall be applied by substituting '100 percent' for '15 percent'.

"(3) REHABILITATION EXPENDITURES.—For purposes of this subsection—

"(A) IN GENERAL.—Except as provided in this paragraph, the term 'rehabilitation expenditures' means any amount properly chargeable to capital account which is incurred by the person acquiring the building for property (or additions or improvements to property) in connection with the rehabilitation of a building. In the case of an integrated operation contained in a building before its acquisition, such term includes rehabilitating existing equipment in such building or replacing it with equipment having substantially the same function. For purposes of this subparagraph, any amount incurred by a successor to the person acquiring the building or by the seller under a sales contract with such person shall be treated as incurred by such person.

"(B) CERTAIN EXPENDITURES NOT INCLUDED.—The term 'rehabilitation expenditures' does not include any expenditure described in section 48(g)(2)(B).

"(C) PERIOD DURING WHICH EXPENDITURES MUST BE INCURRED.—The term 'rehabilitation expenditures' shall not include any amount which is incurred after the date 2 years after the later of—

"(i) the date on which the building was acquired, or

"(ii) the date on which the bond was issued.

"(4) SPECIAL RULE FOR CERTAIN PROJECTS.—In the case of a project involving 2 or more buildings, this subsection shall be applied on a project basis.

"(e) NO PORTION OF BONDS MAY BE ISSUED FOR SKYBOXES, AIRPLANES, GAMBLING ESTABLISHMENTS, ETC.—A private activity bond hall not be treated as a qualified bond if issued as part of an issue and any portion of the proceeds of such issue is to be used to provide any airplane, skybox or other private luxury box, health club facili-y, facility primarily used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises.

"(f) PUBLIC APPROVAL REQUIRED FOR PRIVATE ACTIVITY BONDS.—

"(1) IN GENERAL.—A private activity bond shall not be a qualified bond unless such bond satisfies the requirements of paragraph (2).

"(2) PUBLIC APPROVAL REQUIREMENT.—

"(A) IN GENERAL.—A bond shall satisfy the requirements of this paragraph if such bond is issued as a part of an issue which has been approved by—

"(i) the governmental unit—

"(I) which issued such bond, or

"(II) on behalf of which such bond was issued, and

"(ii) each governmental unit having jurisdiction over the area in which any facility, with respect to which financing is to be provided from the net proceeds of such issue, is located (except that if more than 1 governmental unit within a State has jurisdiction over the entire area within such State in which such facility is located, only 1 such unit need approve such issue).

"(B) APPROVAL BY A GOVERNMENTAL UNIT.—For purposes of subparagraph (A), an issue shall be treated as having been approved by any governmental unit if such issue is approved—

"(i) by the applicable elected representative of such governmental unit after a public hearing following reasonable public notice, or

"(ii) by voter referendum of such governmental unit.

"(C) SPECIAL RULES FOR APPROVAL OF FACILITY.—If there has been public approval under subparagraph (A) of the plan for financing a facility, such approval shall constitute approval under subparagraph (A) for any issue—

"(i) which is issued pursuant to such plan within 3 years after the date of the 1st issue pursuant to the approval, and

"(ii) all or substantially all of the proceeds of which are to be used to finance such facility or to refund previous financing under such plan.

"(D) Refunding bonds.—No approval under subparagraph (A) shall be necessary with respect to any bond which is issued to refund (other than to advance refund) a bond approved under subparagraph (A) (or treated as approved under subparagraph (C)) unless the maturity date of such bond is later than the maturity date of the bond to be refunded.

"(E) Applicable elected representative.—For purposes of this paragraph—

"(i) In general.—The term 'applicable elected representative' means with respect to any governmental unit—

"(I) an elected legislative body of such unit, or

"(II) the chief elected executive officer, the chief elected State legal officer of the executive branch, or any other elected official of such unit designated for purposes of this paragraph by such chief elected executive officer or by State law.

"(ii) No applicable elected representative.—If (but for this clause) a governmental unit has no applicable elected representative, the applicable elected representative for purposes of clause (i) shall be the applicable elected representative of the governmental unit—

"(I) which is the next higher governmental unit with such a representative, and

"(II) from which the authority of the governmental unit with no such representative is derived.

"(3) Special rule for approval of airports.—If—

"(A) the proceeds of an issue are to be used to finance a facility or facilities located at an airport, and

"(B) the governmental unit issuing such bonds is the owner or operator of such airport,

such governmental unit shall be deemed to be the only governmental unit having jurisdiction over such airport for purposes of this subsection.

"(g) Restriction on Issuance Costs Financed by Issue.—

"(1) In general.—A private activity bond shall not be a qualified bond if the issuance costs financed by the issue (of which such bond is a part) exceed 2 percent of the aggregate face amount of the issue.

"(2) Special rule for small mortgage revenue bond issues.—In the case of an issue of qualified mortgage bonds or qualified veterans' mortgage bonds, paragraph (1) shall be applied by substituting '3.5 percent' for '2 percent' if the aggregate authorized face amount of the issue does not exceed $20,000,000.

"(h) Certain Rules Not To Apply to Mortgage Revenue Bonds, Qualified Student Loan Bonds, and Qualified 501(c)(3) Bonds.—

"(1) Mortgage revenue bonds and qualified student loan bonds.—Subsections (a), (b), (c), and (d) shall not apply to

any qualified mortgage bond, qualified veterans' mortgage bond, or qualified student loan bond.

"(2) Qualified 501(c)(3) bonds.—Subsections (a), (c), and (d) shall not apply to any qualified 501(c)(3) bond and subsection (e) shall be applied as if it did not contain 'health club facility' with respect to such a bond.

"Subpart B—Requirements Applicable to All State and Local Bonds

"Sec. 148. Arbitrage.
"Sec. 149. Bonds must be registered to be tax exempt; other requirements.

"SEC. 148. ARBITRAGE.

"(a) Arbitrage Bond Defined.—For purposes of section 103, the term 'arbitrage bond' means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly—

"(1) to acquire higher yielding investments, or

"(2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

For purposes of this subsection, a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraph (1) or (2).

"(b) Higher Yielding Investments.—For purposes of this section—

"(1) In general.—The term 'higher yielding investments' means any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

"(2) Investment property.—The term 'investment property' means—

"(A) any security (within the meaning of section 165(g)(2)(A) or (B)),

"(B) any obligation,

"(C) any annuity contract, or

"(D) any investment-type property.

Such term shall not include any tax-exempt bond.

"(c) Temporary Period Exception.—

"(1) In general.—For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

"(2) Limitation on temporary period for pooled financings.—

"(A) In general.—The temporary period referred to in paragraph (1) shall not exceed 6 months with respect to the proceeds of an issue which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons.

"(B) Special rule for certain student loan pools.—In the case of the proceeds of an issue to be used to make or

finance loans under a program described in section 144(b)(1)(A), subparagraph (A) shall be applied by substituting '18 months' for '6 months'. The preceding sentence shall not apply to any bond issued after December 31, 1988.

"(C) SHORTER TEMPORARY PERIOD FOR LOAN REPAYMENTS, ETC.—Subparagraph (A) shall be applied by substituting '3 months' for '6 months' with respect to the proceeds from the sale or repayment of any loan which are to be used to make or finance any loan. For purposes of the preceding sentence, a nonpurpose investment shall not be treated as a loan.

"(D) EXCEPTION FOR MORTGAGE REVENUE BONDS.—This paragraph shall not apply to any qualified mortgage bond or qualified veterans' mortgage bond.

"(d) SPECIAL RULES FOR REASONABLY REQUIRED RESERVE OR REPLACEMENT FUND.—

"(1) IN GENERAL.—For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of the issue of which such bond is a part may be invested in higher yielding investments which are part of a reasonably required reserve or replacement fund. The amount referred to in the preceding sentence shall not exceed 10 percent of the proceeds of such issue unless the issuer establishes to the satisfaction of the Secretary that a higher amount is necessary.

"(2) LIMITATION ON AMOUNT IN RESERVE OR REPLACEMENT FUND WHICH MAY BE FINANCED BY ISSUE.—A bond issued as part of an issue shall be treated as an arbitrage bond if the amount of the proceeds from the sale of such issue which is part of any fund described in paragraph (1) exceeds 10 percent of the proceeds of the issue (or such higher amount which the issuer establishes is necessary to the satisfaction of the Secretary).

"(3) LIMITATION ON INVESTMENT IN NONPURPOSE INVESTMENTS.—

"(A) IN GENERAL.—A bond which is part of an issue which does not meet the requirements of subparagraph (B) shall be treated as an arbitrage bond.

"(B) REQUIREMENTS.—An issue meets the requirements of this subparagraph only if—

"(i) at no time during any bond year may the amount invested in nonpurpose investments with a yield materially higher than the yield on the issue exceed 150 percent of the debt service on the issue for the bond year, and

"(ii) the aggregate amount invested as provided in clause (i) is promptly and appropriately reduced as the amount of outstanding bonds of the issue is reduced (or, in the case of a qualified mortgage bond or a qualified veterans' mortgage bond, as the mortgages are repaid).

"(C) EXCEPTIONS FOR TEMPORARY PERIOD.—Subparagraph (B) shall not apply to—

"(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the governmental purpose of the issue, and

"(ii) temporary investment periods related to debt service.

"(D) Debt service defined.—For purposes of this paragraph, the debt service on the issue for any bond year is the scheduled amount of interest and amortization of principal payable for such year with respect to such issue. For purposes of the preceding sentence, there shall not be taken into account amounts scheduled with respect to any bond which has been redeemed before the beginning of the bond year.

"(E) No disposition in case of loss.—This paragraph shall not require the sale or disposition of any investment if such sale or disposition would result in a loss which exceeds the amount which, but for such sale or disposition, would at the time of such sale or disposition—

"(i) be paid to the United States, or,

"(ii) in the case of a qualified mortgage bond or a qualified veterans' mortgage bond, be paid or credited mortgagors under section 143(g)(3)(A).

"(F) Exception for governmental use bonds and qualified 501(c)(3) bonds.—This paragraph shall not apply to any bond which is not a private activity bond or which is a qualified 501(c)(3) bond.

"(e) Minor Portion May Be Invested in Higher Yielding Investments.—Notwithstanding subsections (a), (c), and (d), a bond issued as part of an issue shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of such issue (in addition to the amounts under subsections (c) and (d)) is invested in higher yielding investments if such amount does not exceed the lesser of—

"(1) 5 percent of the proceeds of the issue, or

"(2) $100,000.

"(f) Required Rebate to the United States.—

"(1) In general.—A bond which is part of an issue shall be treated as an arbitrage bond if the requirements of paragraphs (2) and (3) are not met with respect to such issue. The preceding sentence shall not apply to any qualified mortgage bond or qualified veterans' mortgage bond.

"(2) Rebate to united states.—An issue shall be treated as meeting the requirements of this paragraph only if an amount equal to the sum of—

"(A) the excess of—

"(i) the amount earned on all nonpurpose investments (other than investments attributable to an excess described in this subparagraph), over

"(ii) the amount which would have been earned if such nonpurpose investments were invested at a rate equal to the yield on the issue, plus

"(B) any income attributable to the excess described in subparagraph (A),

is paid to the United States by the issuer in accordance with the requirements of paragraph (3).

"(3) DUE DATE OF PAYMENTS UNDER PARAGRAPH (2).—Except to the extent provided by the Secretary, the amount which is required to be paid to the United States by the issuer shall be paid in installments which are made at least once every 5 years. Each installment shall be in an amount which ensures that 90 percent of the amount described in paragraph (2) with respect to the issue at the time payment of such installment is required will have been paid to the United States. The last installment shall be made no later than 60 days after the day on which the last bond of the issue is redeemed and shall be in an amount sufficient to pay the remaining balance of the amount described in paragraph (2) with respect to such issue.

"(4) SPECIAL RULES FOR APPLYING PARAGRAPH (2).—

"(A) IN GENERAL.—In determining the aggregate amount earned on nonpurpose investments for purposes of paragraph (2)—

"(i) any gain or loss on the disposition of a nonpurpose investment shall be taken into account, and

"(ii) unless the issuer otherwise elects, any amount earned on a bona fide debt service fund shall not be taken into account if the gross earnings on such fund for the bond year is less than $100,000.

"(B) TEMPORARY INVESTMENTS.—Under regulations prescribed by the Secretary—

"(i) IN GENERAL.—An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraph (2) if the gross proceeds of such issue are expended for the governmental purpose for which the issue was issued by no later than the day which is 6 months after the date of issuance of such issue. Gross proceeds which are held in a bona fide debt service fund shall not be considered gross proceeds for purposes of this subparagraph only.

"(ii) ADDITIONAL PERIOD FOR CERTAIN BONDS.—

"(I) IN GENERAL.—In the case of an issue described in subclause (II), clause (i) shall be applied by substituting '1 year' for '6 months' with respect to the portion of the proceeds of the issue which are not expended in accordance with clause (i) if such portion does not exceed the lesser of 5 percent of the proceeds of the issue or $100,000.

"(II) ISSUES TO WHICH SUBCLAUSE (I) APPLIES.—An issue is described in this subclause if no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond) or a tax or revenue anticipation bond.

"(iii) SAFE HARBOR FOR DETERMINING WHEN PROCEEDS OF TAX AND REVENUE ANTICIPATION BONDS ARE EXPENDED.—

"(I) IN GENERAL.—For purposes of clause (i), in the case of an issue of tax or revenue anticipation bonds, the net proceeds of such issue (including

earnings thereon) shall be treated as expended for the governmental purpose of the issue on the 1st day after the date of issuance that the cumulative cash flow deficit to be financed by such issue exceeds 90 percent of the aggregate face amount of such issue.

"(II) CUMULATIVE CASH FLOW DEFICIT.—For purposes of subclause (I), the term 'cumulative cash flow deficit' means, as of the date of computation, the excess of the expenses paid during the period described in subclause (III) which would ordinarily be paid out of or financed by anticipated tax or other revenues over the aggregate amount available (other than from the proceeds of the issue) during such period for the payment of such expenses.

"(III) PERIOD INVOLVED.—For purposes of subclause (II), the period described in this subclause is the period beginning on the date of issuance of the issue and ending on the earliest of the maturity date of the issue, the date 6 months after such date of issuance, or the date of the computation of cumulative cash flow deficit.

"(C) EXCEPTION FOR SMALL GOVERNMENTAL UNITS.—An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraphs (2) and (3) if—

"(i) the issue is issued by a governmental unit with general taxing powers,

"(ii) no bond which is part of such issue is a private activity bond,

"(iii) 95 percent or more of the net proceeds of such issue are to be used for local governmental activities of the issuer (or of a governmental unit the jurisdiction of which is entirely within the jurisdiction of the issuer), and

"(iv) the aggregate face amount of all tax-exempt bonds (other than private activity bonds) issued by such unit (and all subordinate entities thereof) during the calendar year in which such issue is issued is not reasonably expected to exceed $5,000,000.

Clause (iv) shall not take into account any bond which is not outstanding at the time of a later issue or which is redeemed (other than in an advance refunding) from the net proceeds of the later issue.

"(D) EXCEPTION FOR CERTAIN QUALIFIED STUDENT LOAN BONDS.—

"(i) IN GENERAL.—In determining the aggregate amount earned on nonpurpose investments acquired with gross proceeds of an issue of bonds described in section 144(b)(1)(A), the amount earned from investment of net proceeds of such issue during the initial temporary period under subsection (c) shall not be taken into account to the extent that the amount so earned is used to pay the reasonable—

"(I) administrative costs of such a program attributable to such issue and the costs of carrying such issue, and

"(II) costs of issuing such issue,

but only to the extent such costs were financed with proceeds of such issue and for which the issuer was not reimbursed.

"(ii) ONLY ARBITRAGE ON AMOUNTS LOANED DURING TEMPORARY PERIOD TAKEN INTO ACCOUNT FOR ADMINISTRATIVE COSTS, ETC.—The amount earned from investment of net proceeds of an issue during the initial temporary period under subsection (c) shall be taken into account under clause (i)(I) only to the extent attributable to proceeds which were used to make or finance (not later than the close of such period) student loans under a program described in section 144(b)(1)(A).

"(iii) ELECTION.—This subparagraph shall not apply to any issue if the issuer elects not to have this subparagraph apply to such issue.

"(iv) TERMINATION.—This subparagraph shall not apply to any bond issued after December 31, 1988.

"(5) EXEMPTION FROM GROSS INCOME OF SUM REBATED.—Gross income shall not include the sum described in paragraph (2). Notwithstanding any other provision of this title, no deduction shall be allowed for any amount paid to the United States under paragraph (2).

"(6) DEFINITIONS.—For purposes of this subsection and subsections (c) and (d)—

"(A) NONPURPOSE INVESTMENT.—The term 'nonpurpose investment' means any investment property which—

"(i) is acquired with the gross proceeds of an issue, and

"(ii) is not acquired in order to carry out the governmental purpose of the issue.

"(B) GROSS PROCEEDS.—Except as otherwise provided by the Secretary, the gross proceeds of an issue include—

"(i) amounts received (including repayments of principal) as a result of investing the original proceeds of the issue, and

"(ii) amounts to be used to pay debt service on the issue.

"(7) PENALTY IN LIEU OF LOSS OF TAX EXEMPTION.—In the case of an issue which would (but for this paragraph) fail to meet the requirements of paragraph (2) or (3), the Secretary may treat such issue as not failing to meet such requirements if—

"(A) no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond),

"(B) the failure to meet such requirements is due to reasonable cause and not to willful neglect, and

"(C) the issuer pays to the United States a penalty in an amount equal to the sum of—

"(i) 50 percent of the amount which was not paid in accordance with paragraphs (2) and (3), plus

"(ii) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required under paragraph (3) for the period beginning on such date.

The Secretary may waive all or any portion of the penalty under this paragraph.

"(g) STUDENT LOAN INCENTIVE PAYMENTS.—Except to the extent otherwise provided in regulations, payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965 are not to be taken into account, for purposes of subsection (a)(1), in determining yields on student loan notes.

"(h) DETERMINATIONS OF YIELD.—For purposes of this section, the yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).

"(i) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

"SEC. 149. BONDS MUST BE REGISTERED TO BE TAX EXEMPT; OTHER REQUIREMENTS.

"(a) BONDS MUST BE REGISTERED TO BE TAX EXEMPT.—

"(1) GENERAL RULE.—Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required bond unless such bond is in registered form.

"(2) REGISTRATION-REQUIRED BOND.—For purposes of paragraph (1), the term 'registration-required bond' means any bond other than a bond which—

"(A) is not of a type offered to the public,

"(B) has a maturity (at issue) of not more than 1 year, or

"(C) is described in section 163(f)(2)(B).

"(3) SPECIAL RULES.—

"(A) BOOK ENTRIES PERMITTED.—For purposes of paragraph (1), a book entry bond shall be treated as in registered form if the right to the principal of, and stated interest on, such bond may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

"(B) NOMINEES.—The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.

"(b) FEDERALLY GUARANTEED BOND IS NOT TAX EXEMPT.—

"(1) IN GENERAL.—Section 103(a) shall not apply to any State or local bond if such bond is federally guaranteed.

"(2) FEDERALLY GUARANTEED DEFINED.—For purposes of paragraph (1), a bond is federally guaranteed if—

"(A) the payment of principal or interest with respect to such bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof),

"(B) such bond is issued as part of an issue and 5 percent or more of the proceeds of such issue is to be—

"(i) used in making loans the payment of principal or interest with respect to which are to be guaranteed

(in whole or in part) by the United States (or any agency or instrumentality thereof), or

"(ii) invested (directly or indirectly) in federally insured deposits or accounts, or

"(C) the payment of principal or interest on such bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof).

"(3) Exceptions.—

"(A) Certain insurance programs.—A bond shall not be treated as federally guaranteed by reason of—

"(i) any guarantee by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association,

"(ii) any guarantee of student loans and any guarantee by the Student Loan Marketing Association to finance student loans, or

"(iii) any guarantee by the Bonneville Power Authority pursuant to the Northwest Power Act (16 U.S.C. 839d) as in effect on the date of the enactment of the Tax Reform Act of 1984 with respect to any bond issued before July 1, 1989.

"(B) Debt service, etc.—Paragraph (1) shall not apply to—

"(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the purpose for which such issue was issued,

"(ii) investments of a bona fide debt service fund,

"(iii) investments of a reserve which meet the requirements of section 148(d),

"(iv) investments in bonds issued by the United States Treasury, or

"(v) other investments permitted under regulations.

"(C) Exception for housing programs.—

"(i) In general.—Except as provided in clause (ii), paragraph (1) shall not apply to—

"(I) a private activity bond for a qualified residential rental project or a housing program obligation under section 11(b) of the United States Housing Act of 1937,

"(II) a qualified mortgage bond, or

"(III) a qualified veterans' mortgage bond.

"(ii) Exception not to apply where bond invested in federally insured deposits or accounts.—Clause (i) shall not apply to any bond which is federally guaranteed within the meaning of paragraph (2)(B)(ii).

"(D) Loans to, or guarantees by, financial institutions.—Except as provided in paragraph (2)(B)(ii), a bond which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that the proceeds of such issue are used in making loans to a financial institution or there is a guarantee by a financial insti-

tution unless such guarantee constitutes a federally insured deposit or account.

"(4) DEFINITIONS.—*For purposes of this subsection—*

"(A) TREATMENT OF CERTAIN ENTITIES WITH AUTHORITY TO BORROW FROM UNITED STATES.—*To the extent provided in regulations prescribed by the Secretary, any entity with statutory authority to borrow from the United States shall be treated as an instrumentality of the United States. Except in the case of an exempt facility bond, a qualified small issue bond, a qualified student loan bond, and a qualified redevelopment bond, nothing in the preceding sentence shall be construed as treating the District of Columbia or any possession of the United States as an instrumentality of the United States.*

"(B) FEDERALLY INSURED DEPOSIT OR ACCOUNT.—*The term 'federally insured deposit or account' means any deposit or account in a financial institution to the extent such deposit or account is insured under Federal law by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Administration, or any similar federally chartered corporation.*

"(c) TAX EXEMPTION MUST BE DERIVED FROM THIS TITLE.—

"(1) GENERAL RULE.—*Except as provided in paragraph (2), no interest on any bond shall be exempt from taxation under this title unless such interest is exempt from tax under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act.*

"(2) CERTAIN PRIOR EXEMPTIONS.—

"(A) PRIOR EXEMPTIONS CONTINUED.—*For purposes of this title, notwithstanding any provision of this part, any bond the interest on which is exempt from taxation under this title by reason of any provision of law (other than a provision of this title) which is in effect on January 6, 1983, shall be treated as a bond described in section 103(a).*

"(B) ADDITIONAL REQUIREMENTS FOR BONDS ISSUED AFTER 1983.—*Subparagraph (A) shall not apply to a bond (not described in subparagraph (C)) issued after 1983 if the appropriate requirements of this part (or the corresponding provisions of prior law) are not met with respect to such bond.*

"(C) DESCRIPTION OF BOND.—*A bond is described in this subparagraph (and treated as described in subparagraph (A)) if—*

"(i) *such bond is issued pursuant to the Northwest Power Act (16 U.S.C. 839d), as in effect on July 18, 1984;*

"(ii) *such bond is issued pursuant to section 608(a)(6)(A) of Public Law 97-468, as in effect on the date of the enactment of the Tax Reform Act of 1986; or*

"(iii) *such bond is issued before June 19, 1984 under section 11(b) of the United States Housing Act of 1937.*

"(d) ADVANCE REFUNDINGS.—

"(1) In general.—Nothing in section 103(a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in paragraph (2), (3), or (4).

"(2) Certain private activity bonds.—An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond).

"(3) Other bonds.—

"(A) In general.—An issue is described in this paragraph if any bond (issued as part of such issue), hereinafter in this paragraph referred to as the 'refunding bond', is issued to advance refund a bond unless—

"(i) the refunding bond is only—

"(I) the 1st advance refunding of the original bond if the original bond is issued after 1985, or

"(II) the 1st or 2nd advance refunding of the original bond if the original bond was issued before 1986,

"(ii) in the case of refunded bonds issued before 1986, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed at par or at a premium of 3 percent or less,

"(iii) in the case of refunded bonds issued after 1985, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed,

"(iv) the initial temporary period under section 148(c) ends—

"(I) with respect to the proceeds of the refunding bond not later than 30 days after the date of issue of such bond, and

"(II) with respect to the proceeds of the refunded bond on the date of issue of the refunding bond, and

"(v) in the case of refunded bonds to which section 148(e) did not apply, on and after the date of issue of the refunding bond, the amount of proceeds of the refunded bond invested in higher yielding investments (as defined in section 148(b)) which are nonpurpose investments as defined in section 148(f)(6)(A) does not exceed—

"(I) the amount so invested as part of a reasonably required reserve or replacement fund or during an allowable temporary period, and

"(II) the amount which is equal to the lesser of 5 percent of the proceeds of the issue of which the refunded bond is a part or $100,000 (to the extent such amount is allocable to the refunded bond).

"(B) Special rules for redemptions.—

"(i) Issuer must redeem only if debt service savings.—Clause (ii) and (iii) of subparagraph (A) shall apply only if the issuer may realize present value debt service savings (determined without regard to adminis-

trative expenses) in connection with the issue of which the refunding bond is a part.

"(ii) REDEMPTIONS NOT REQUIRED BEFORE 90TH DAY.—For purposes of clauses (ii) and (iii) of subparagraph (A), the earliest date referred to in such clauses shall not be earlier than the 90th day after the date of issuance of the refunding bond.

"(4) ABUSIVE TRANSACTIONS PROHIBITED.—An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund another bond and a device is employed in connection with the issuance of such issue to obtain a material financial advantage (based on arbitrage) apart from savings attributable to lower interest rates.

"(5) ADVANCE REFUNDING.—For purposes of this part, a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

"(6) SPECIAL RULES FOR PURPOSES OF PARAGRAPH (3).—For purposes of paragraph (3), bonds issued before the date of the enactment of this subsection shall be taken into account under subparagraph (A)(i) thereof except—

"(A) a refunding which occurred before 1986 shall be treated as an advance refunding only if the refunding bond was issued more than 180 days before the redemption of the refunded bond, and

"(B) a bond issued before 1986, shall be treated as advance refunded no more than once before March 15, 1986.

"(7) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

"(e) INFORMATION REPORTING.—

"(1) IN GENERAL.—Nothing in section 103(a) or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond unless such bond satisfies the requirements of paragraph (2).

"(2) INFORMATION REPORTING REQUIREMENTS.—A bond satisfies the requirements of this paragraph if the issuer submits to the Secretary, not later than the 15th day of the 2d calendar month after the close of the calendar quarter in which the bond is issued (or such later time as the Secretary may prescribe with respect to any portion of the statement), a statement concerning the issue of which the bond is a part which contains—

"(A) the name and address of the issuer,

"(B) the date of issue, the amount of net proceeds of the issue, the stated interest rate, term, and face amount of each bond which is part of the issue, the amount of issuance costs of the issue, and the amount of reserves of the issue,

"(C) where required, the name of the applicable elected representative who approved the issue, or a description of the voter referendum by which the issue was approved,

"(D) the name, address, and employer identification number of—

"(i) each initial principal user of any facility provided with the proceeds of the issue,

"(ii) the common parent of any affiliated group of corporations (within the meaning of section 1504(a)) of which such initial principal user is a member, and

"(iii) if the issue is treated as a separate issue under section 144(a)(6)(A), any person treated as a principal user under section 144(a)(6)(B),

"(E) a description of any property to be financed from the proceeds of the issue,

"(F) a certification by a State official designated by State law (or, where there is no such official, the Governor) that the bond meets the requirements of section 146 (relating to cap on private activity bonds), if applicable, and

"(G) such other information as the Secretary may require. Subparagraphs (C) and (D) shall not apply to any bond which is not a private activity bond. The Secretary may provide that certain information specified in the 1st sentence need not be included in the statement with respect to an issue where the inclusion of such information is not necessary to carry out the purposes of this subsection.

"(3) EXTENSION OF TIME.—The Secretary may grant an extension of time for the filing of any statement required under paragraph (2) if there is reasonable cause for the failure to file such statement in a timely fashion.

"Subpart C—Definitions and Special Rules

"Sec. 150. Definitions and special rules.

"SEC. 150. DEFINITIONS AND SPECIAL RULES.

"(a) GENERAL RULE.—For purposes of this part—

"(1) BOND.—The term 'bond' includes any obligation.

"(2) GOVERNMENTAL UNIT NOT TO INCLUDE FEDERAL GOVERNMENT.—The term 'governmental unit' does not include the United States or any agency or instrumentality thereof.

"(3) NET PROCEEDS.—The term 'net proceeds' means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or replacement fund.

"(4) 501(c)(3) ORGANIZATION.—The term '501(c)(3) organization' means any organization described in section 501(c)(3) and exempt from tax under section 501(a).

"(5) OWNERSHIP OF PROPERTY.—Property shall be treated as owned by a governmental unit if it is owned on behalf of such unit.

"(6) TAX-EXEMPT BOND.—The term 'tax-exempt' means, with respect to any bond (or issue), that the interest on such bond (or on the bonds issued as part of such issue) is excluded from gross income.

"(b) CHANGE IN USE OF FACILITIES FINANCED WITH TAX-EXEMPT PRIVATE ACTIVITY BONDS.—

"(1) MORTGAGE REVENUE BONDS.—

"(A) IN GENERAL.—In the case of any residence with respect to which financing is provided from the proceeds of a

qualified mortgage bond or qualified veterans' mortgage bond, if there is a continuous period of at least 1 year during which such residence is not the principal residence of at least 1 of the mortgagors who received such financing, then no deduction shall be allowed under this chapter for interest on such financing which accrues on or after the date such period began.

"(B) Exception.—Subparagraph (A) shall not apply to the extent the Secretary determines that its application would result in undue hardship and that the failure to meet the requirements of subparagraph (A) resulted from circumstances beyond the mortgagor's control.

"(2) Qualified residential rental projects.—In the case of any project for residential rental property—

"(A) with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt bond described paragraph (7) of section 142(a), and

"(B) which does not meet the requirements of section 142(d),

no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the 1st day of the taxable year in which such project fails to meet such requirements and ending on the date such project meets such requirements.

"(3) Qualified 501(c)(3) bonds.—

"(A) In general.—In the case of any facility with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt qualified 501(c)(3) bond, if any portion of such facility—

"(i) is used in a trade or business of any person other than a 501(c)(3) organization or a governmental unit, but

"(ii) continues to be owned by a 501(c)(3) organization,

then the owner of such portion shall be treated for purposes of this title as engaged in an unrelated trade or business (as defined in section 513) with respect to such portion. The amount of gross income attributable to such portion for any period shall not be less than the fair rental value of such portion for such period.

"(B) Denial of deduction for interest.—No deduction shall be allowed under this chapter for interest on financing described in subparagraph (A) which accrues during the period beginning on the date such facility is used as described in subparagraph (A)(i) and ending on the date such facility is not so used.

"(4) Certain exempt facility bonds.—

"(A) In general.—In the case of any facility with respect to which financing is provided from the proceeds of any private activity bond to which this paragraph applies, if such facility is not used for a purpose for which a tax-exempt bond could be issued on the date of such issue, no

deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the date such facility is not so used and ending on the date such facility is so used.

"(B) Bonds to which paragraph applies.—This paragraph applies to any private activity bond which, when issued, purported to be a tax-exempt exempt facility bond described in a paragraph (other than paragraph (7)) of section 142(a).

"(5) Facilities required to be owned by governmental units or 501(c)(3) organizations.—If—

"(A) financing is provided with respect to any facility from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt bond,

"(B) such facility is required to be owned by a governmental unit or a 501(c)(3) organization as a condition of such tax exemption, and

"(C) such facility is not so owned,

then no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the date such facility is not so owned and ending on the date such facility is so owned.

"(c) Exception and Special Rules for Purposes of Subsection (b).—For purposes of subsection (b)—

"(1) Exception.—Any use with respect to facilities financed with proceeds of an issue which are not required to be used for the exempt purpose of such issue shall not be taken into account.

"(2) Treatment of amounts other than interest.—If the amounts payable for the use of a facility are not interest, subsection (b) shall apply to such amounts as if they were interest but only to the extent such amounts for any period do not exceed the amount of interest accrued on the bond financing for such period.

"(3) Use of portion of facility.—In the case of any person which uses only a portion of the facility, only the interest accruing on the financing allocable to such portion shall be taken into account by such person.

"(4) Cessation with respect to portion of facility.—In the case of any facility where part but not all of the facility is not used for an exempt purpose, only the interest accruing on the financing allocable to such part shall be taken into account.

"(5) Regulations.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and subsection (b).

"(d) Qualified Scholarship Funding Bond.—For purposes of this part and section 103—

"(1) Treatment as State or local bond.—A qualified scholarship funding bond shall be treated as a State or local bond.

"(2) Qualified scholarship funding bond defined.—The term 'qualified scholarship funding bond' means a bond issued by a corporation which—

"(A) is a corporation not for profit established and operated exclusively for the purpose of acquiring student loan

notes incurred under the Higher Education Act of 1965, and

"(B) is organized at the request of the State or 1 or more political subdivisions thereof or is requested to exercise such power by 1 or more political subdivisions and required by its corporate charter and bylaws, or required by State law, to devote any income (after payment of expenses, debt service, and the creation of reserves for the same) to the purchase of additional student loan notes or to pay over any income to the United States.

"(e) BONDS OF CERTAIN VOLUNTEER FIRE DEPARTMENTS.—For purposes of this part and section 103—

"(1) IN GENERAL.—A bond of a volunteer fire department shall be treated as a bond of a political subdivision of a State if—

"(A) such department is a qualified volunteer fire department with respect to an area within the jurisdiction of such political subdivision, and

"(B) such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of a firehouse or firetruck used or to be used by such department.

"(2) QUALIFIED VOLUNTEER FIRE DEPARTMENT.—For purposes of this subsection, the term 'qualified volunteer fire department' means, with respect to a political subdivision of a State, any organization—

"(A) which is organized and operated to provide firefighting or emergency medical services for persons in an area (within the jurisdiction of such political subdivision) which is not provided with any other firefighting services, and

"(B) which is required (by written agreement) by the political subdivision to furnish firefighting services in such area."

(c) AMENDMENT TO ARBITRAGE REGULATIONS.—The provision in the Federal income tax regulations relating to the arbitrage requirements which permits a higher yield on acquired obligations if the issuer elects to waive the benefits of the temporary period provisions shall not apply to bonds issued after August 31, 1986.

(d) STATE AND LOCAL GOVERNMENT SERIES MODIFICATIONS.—Notwithstanding any other provision of law or any regulations promulgated thereunder (including the provisions of 31 CFR part 344) the Secretary of the Treasury shall extend by January 1, 1987, the State and Local Government Series program to provide—

(1) instruments allowing flexible investment of bond proceeds in a manner eliminating the earning of rebatable arbitrage,

(2) demand deposits under such program by eliminating advance notice and minimum maturity requirements related to the purchase of bonds,

(3) operation of such program at no net cost to the Federal Government, and

(4) deposits for a stated maturity under reasonable advance notice requirements.

(e) MANAGEMENT CONTRACTS.—The Secretary of the Treasury or his delegate shall modify the Secretary's advance ruling guidelines relating to when use of property pursuant to a management contract is not considered a trade or business use by a private person for purposes of section 141(a) of the Internal Revenue Code of 1986 to provide that use pursuant to a management contract generally shall not be treated as trade or business use as long as—

(1) the term of such contract (including renewal options) does not exceed 5 years,

(2) the exempt owner has the option to cancel such contract at the end of any 3-year period,

(3) the manager under the contract is not compensated (in whole or in part) on the basis of a share of net profits, and

(4) at least 50 percent of the annual compensation of the manager under such contract is based on a periodic fixed fee.

(f) AMENDMENTS RELATING TO MORTGAGE CREDIT CERTIFICATE PROGRAM.—

(1) TRADE-IN RATE INCREASED TO 25 PERCENT.—

(A) Subparagraph (A) of section 25(d)(2) (relating to aggregate limit of certificate credit rates) is amended by striking out "20 percent" and inserting in lieu thereof "25 percent".

(B) Subparagraph (A) of section 25(f)(2) (defining correction amount) is amended by striking out "0.20" and inserting in lieu thereof "0.25".

(2) CONFORMING AMENDMENTS.—

(A) Clause (ii) of section 25(b)(2)(A) (defining certificate indebtedness amount) is amended by striking out "section 103A(l)(6)" and inserting in lieu thereof "section 143(k)(4)".

(B) Clause (iii) of section 25(b)(2)(A) is amended by striking out "section 103A(l)(7)" and inserting in lieu thereof "section 143(k)(5)".

(C)(i) Subparagraphs (A)(iii) and (B) of section 25(c)(2) are each amended by striking out "section 103A" each place it appears and inserting in lieu thereof "section 143".

(ii) Clause (ii) of section 25(c)(2)(A) is amended by striking out "section 103A" and inserting in lieu thereof "section 103".

(D) Clause (iii) of section 25(c)(2)(A) (defining qualified mortgage credit certificate program) is amended by striking out all the subclauses thereof and inserting in lieu thereof the following:

"(I) subsection (c) (relating to residence requirements),

"(II) subsection (d) (relating to 3-year requirement),

"(III) subsection (e) (relating to purchase price requirement),

"(IV) subsection (f) (relating to income requirements),

"(V) subsection (h) (relating to portion of loans required to be placed in targeted areas), and

"(VI) paragraph (1) of subsection (i) (relating to other requirements),".

(E) The last sentence of subparagraph (A) of section 25(c)(2) is amended by striking out "section 103A(c)(2)" and inserting in lieu thereof "section 143(a)(2)".

(F) Subparagraph (B) of section 25(c)(2) is amended—

(i) by striking out "subclauses (II) and (IV)" and inserting in lieu thereof "subclauses (II), (IV), and (V)", and

(ii) by striking out clause (iii) and all that follows and inserting in lieu thereof the following:

"(iii) paragraph (1) of section 143(d) shall be applied by substituting '100 percent' for '95 percent or more'.

Clause (iii) shall not apply if the issuing authority submits a plan to the Secretary for administering the 95-percent requirement of section 143(d)(1) and the Secretary is satisfied that such requirement will be met under such plan."

(G) Subsection (d) of section 25 (relating to determination of certificate credit rate) is amended by striking out paragraph (3).

(H) Paragraph (2) of section 25(e) (relating to indebtedness not treated as certified where certain requirements in fact not met) is amended by striking out "subsection (d)(1), (e), (f), and (j) of section 103A" and inserting in lieu thereof "subsections (c)(1), (d), (e), (f), and (i) of section 143".

(I) Paragraph (6) of section 25(e) is amended by striking out "section 103(b)(6)(C)(i)" and inserting in lieu thereof "section 144(a)(3)(A)".

(J) Subparagraph (A) of section 25(e)(8) is amended by striking out "section 103A(l)(7)(B)" and inserting in lieu thereof "section 143(k)(5)(B)".

(K) Subparagraph (B) of section 25(e)(8) is amended by striking out "section 103A(l)(6)" and inserting in lieu thereof "section 143(k)(4)".

(L) Paragraph (9) of section 25(e) is amended by striking out "section 103A(c)(1)" and inserting in lieu thereof "section 143(a)(1)".

(M) Paragraph (10) of section 25(e) is amended by striking out "section 103A" and inserting in lieu thereof "section 143".

(N) Paragraph (1) of section 25(f) is amended by striking out "paragraph (4) of section 103A(g)" and inserting in lieu thereof "subsection (d) of section 146".

(O) Paragraph (3) of section 25(f) is amended by striking out "section 103A(g)(5)(C)" and inserting in lieu thereof "section 146(d)(3)(C)".

(g) PENALTY FOR FAILURE TO FILE REPORT ON COMPLIANCE WITH QUALIFIED RESIDENTIAL RENTAL PROJECT RULES.—Section 6652 (relating to failure to file certain information returns, registration statements, etc.), as amended by section 1501 of this Act, is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) FAILURE TO FILE CERTIFICATION WITH RESPECT TO CERTAIN RESIDENTIAL RENTAL PROJECTS.—In the case of each failure to provide a certification as required by section 142(d)(7) at the time prescribed therefor, unless it is shown that such failure is due to rea-

sonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by the person failing to provide such certification, an amount equal to $100 for each such failure."

(h) REPEAL OF REPORT ON MORTGAGE REVENUE BOND PROGRAM.—Paragraph (7) of section 611(d) of the Tax Reform Act of 1984 is hereby repealed.

(i) AMENDMENT TO OUTPUT REGULATIONS.—The Secretary of the Treasury or his delegate shall amend the provision in the Federal income tax regulations relating to when use pursuant to certain output contracts is considered to satisfy the private business tests of paragraphs (1) and (2) of section 141(b) of the Internal Revenue Code of 1986 to eliminate the requirement of a 3 percent guaranteed minimum payment.

(j) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) REPEAL OF SECTION 103A.—Section 103A is hereby repealed.

(2) SECTION 143 REDESIGNATED AS SECTION 7703.—

(A) IN GENERAL.—Chapter 79 (relating to definitions) is amended by adding at the end thereof the following new section:

"SEC. 7703. DETERMINATION OF MARITAL STATUS.

"(a) GENERAL RULE.—For purposes of part V of subchapter B of chapter 1 and those provisions of this title which refer to this subsection—

"(1) the determination of whether an individual is married shall be made as of the close of his taxable year; except that if his spouse dies during his taxable year such determination shall be made as of the time of such death; and

"(2) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

"(b) CERTAIN MARRIED INDIVIDUALS LIVING APART.—For purposes of those provisions of this title which refer to this subsection, if—

"(1) an individual who is married (within the meaning of subsection (a)) and who files a separate return maintains as his home a household which constitutes for more than one-half of the taxable year the principal place of abode of a child (within the meaning of section 151(e)(3)) with respect to whom such individual is entitled to a deduction for the taxable year under section 151 (or would be so entitled but for paragraph (2) or (4) of section 152(e)),

"(2) such individual furnishes over one-half of the cost of maintaining such household during the taxable year, and

"(3) during the last 6 months of the taxable year, such individual's spouse is not a member of such household,

such individual shall not be considered as married."

(B) CLERICAL AMENDMENT.—The table of sections for chapter 79 is amended by adding at the end thereof the following new item:

"Sec. 7703. Determination of marital status."

(3) Paragraph (3) of section 163(f) (relating to denial of deductions for interest on certain obligations not in registered form)

is amended by striking out "section 103(j)(3)" and inserting in lieu thereof "section 149(a)(3)".

(4) Sections 269A(b)(3), 414(m)(5), 414(n)(6), and 4988(c)(2) (defining related person) are each amended by striking out "section 103(b)(6)(C)" and inserting in lieu thereof "section 144(a)(3)".

(5) Paragraph (1) of section 4701(b) (defining registration-required obligation) is amended by striking out "section 103(j)" and inserting in lieu thereof "section 149(a)".

(6) Sections 4940(c)(5), 4942(f)(2)(A), and 7871(a)(4) are each amended by striking out "(relating to interest on certain governmental obligations)" and inserting in lieu thereof "(relating to State and local bonds)".

(7) Paragraph (2) of section 7871(c) (relating to no exemption for certain private activity bonds) is amended to read as follows:

"(2) NO EXEMPTION FOR PRIVATE ACTIVITY BONDS.—Subsection (a) of section 103 shall not apply to any private activity bond (as defined in section 141(a)) issued by an Indian tribal government (or subdivision thereof)."

(8) Sections 22(e)(2), 32(c) and (d), 86(c)(3), 152(a)((9), 153(5), 194(b)(1), 1398(d)(2), 3402(f), and 6362(f)(5) are each amended by striking out "section 143" each place it appears and inserting in lieu thereof "section 7703".

(9) Sections 105(d)(5)(C) and 879(c)(3) are each amended by striking out "section 143(a)" and inserting in lieu thereof "section 7703(a)".

(10) Section 2(c) is amended by striking out "section 143(b)" and inserting in lieu thereof "section 7703(b)".

SEC. 1302. TREATMENT OF SECTION 501(c)(3) BONDS.

Nothing in the treatment of section 501(c)(3) bonds as private activity bonds under the amendments made by this title shall be construed as indicating how section 501(c)(3) bonds will be treated in future legislation, and any change in future legislation applicable to private activity bonds shall apply to section 501(c)(3) bonds only if expressly provided in such legislation.

SEC. 1303. REPEAL OF PROVISIONS RELATING TO GENERAL STOCK OWNERSHIP CORPORATIONS.

(a) IN GENERAL.—Subchapter U of chapter 1 (relating to general stock ownership corporation) is hereby repealed.

(b) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 172(b) (relating to net operating loss carrybacks and carryovers) is amended by striking out subparagraph (J) and by redesignating subparagraph (K) as subparagraph (J).

(2) Paragraphs (2) and (4) of section 172(k) are each amended by striking out "subsection (b)(1)(K)" and inserting in lieu thereof "subsection (b)(1)(J)".

(3) Subsection (a) of section 1016 (relating to adjustments to basis) is amended by striking out paragraph (22) and by redesignating paragraphs (23) through (27) as paragraphs (22) through (26), respectively.

(4) Subsection (r) of section 3402 (relating to extension of withholding to GSOC distribution) is hereby repealed.

(5) Section 6039B (relating to return of general stock ownership corporation) is hereby repealed.

(c) CLERICAL AMENDMENTS.—

(1) The table of subchapters for chapter 1 is amended by striking out the item relating to subchapter U.

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 is amended by striking out the item relating to section 6039B.

Subtitle B—Effective Dates and Transitional Rules

SEC. 1311. GENERAL EFFECTIVE DATES.

(a) IN GENERAL.—Except as otherwise provided in this subtitle, the amendments made by section 1301 shall apply to bonds issued after August 15, 1986.

(b) SECTION 1301(f).—

(1) INCREASE IN TRADE-IN RATE.—The amendments made by paragraph (1) of section 1301(f) shall apply to nonissued bond amounts elected after August 15, 1986.

(2) CERTIFICATES.—The amendments made by paragraph (2) of section 1301(f) shall apply to certificates issued after August 15, 1986.

(c) CHANGES IN USE, ETC., OF FACILITIES FINANCED WITH PRIVATE ACTIVITY BONDS.—Subsection (b) of section 150 of the 1986 Code shall apply to changes in use (and ownership) after August 15, 1986, but only with respect to financing (including refinancings) provided after such date.

(d) SECTION 1303.—The amendments made by section 1303 shall take effect on the date of the enactment of this Act.

SEC. 1312. TRANSITIONAL RULES FOR CONSTRUCTION OR BINDING AGREEMENTS AND CERTAIN GOVERNMENT BONDS ISSUED AFTER AUGUST 15, 1986.

(a) EXCEPTION FOR CONSTRUCTION OR BINDING AGREEMENTS.—

(1) IN GENERAL.—The amendments made by section 1301 shall not apply to bonds (other than a refunding bond) with respect to a facility—

(A)(i) the original use of which commences with the taxpayer, and the construction, reconstruction, or rehabilitation of which began before September 26, 1985, and was completed on or after such date,

(ii) the original use of which begins with the taxpayer and with respect to which a binding contract to incur significant expenditures for construction, reconstruction, or rehabilitation was entered into before September 26, 1985, and some of such expenditures are incurred on or after such date, or

(iii) acquired on or after September 26, 1985, pursuant to a binding contract entered into before such date, and

(B) described in an inducement resolution or other comparable preliminary approval adopted by an issuing authority (or by a voter referendum) before September 26, 1985.

(2) Significant expenditures.—For purposes of paragraph (1)(A), the term "significant expenditures" means expenditures greater than 10 percent of the reasonably anticipated cost of the construction, reconstruction, or rehabilitation of the facility involved.

(b) Certain Amendments To Apply to Bonds Under Subsection (a) Transitional Rule.—

(1) In general.—In the case of a bond issued after August 15, 1986, and to which subsection (a) of this section applies, the requirements of the following provisions shall be treated as included in section 103 and section 103A (as appropriate) of the 1954 Code:

(A) The requirement that 95 percent or more of the net proceeds of an issue are to be used for a purpose described in section 103(b)(4) or (5) of such Code in order for section 103(b)(4) or (5) of such Code to apply, including the application of section 142(b)(2) of the 1986 Code (relating to limitation on office space).

(B) The requirement that 95 percent or more of the net proceeds of an issue are to be used for a purpose described in section 103(b)(6)(A) of the 1954 Code in order for section 103(b)(6)(A) of such Code to apply.

(C) The requirements of section 143 of the 1986 Code (relating to qualified mortgage bonds and qualified veterans' mortgage bonds) in order for section 103A(b)(2) of the 1954 Code to apply.

(D) The requirements of section 144(a)(11) of the 1986 Code (relating to limitation on acquisition of depreciable farm property) in order for section 103(b)(6)(A) of the 1954 Code to apply.

(E) The requirements of section 147(b) of the 1986 Code (relating to maturity may not exceed 120 percent of economic life).

(F) The requirements of section 147(f) of the 1986 Code (relating to public approval required for private activity bonds).

(G) The requirements of section 147(g) of the 1986 Code (relating to restriction on issuance costs financed by issue).

(H) The requirements of section 148 of the 1986 Code (relating to arbitrage).

(I) The requirements of section 149(e) of the 1986 Code (relating to information reporting).

(J) The provisions of section 150(b) of the 1986 Code (relating to changes in use).

(2) Certain requirements apply only to bonds issued after December 31, 1986.—In the case of subparagraphs (F) and (I) of paragraphs (1), paragraph (1) shall be applied by substituting "December 31, 1986" for "August 15, 1986".

(3) Application of volume cap.—Except as provided in section 1315, any bond to which this subsection applies shall be treated as a private activity bond for purposes of section 146 of the 1986 Code if such bond would have been taken into account under section 103(n) or 103A(g) of the 1954 Code (determined

without regard to any carryforward election) were such bond issued before August 16, 1986.

(4) Application of provisions.—For purposes of applying the requirements referred to in any subparagraph of paragraph (1) or of subsection (a)(3) or (b)(3) of section 1313 to any bond, such bond shall be treated as described in the subparagraph of section 141(d)(1) of the 1986 Code to which the use of the proceeds of such bond most closely relates.

(c) Special Rules for Certain Government Bonds Issued After August 15, 1986.—

(1) In general.—In the case of any bond described in paragraph (2)—

(A) section 1311(a) and (c) and subsection (b) of this section shall be applied by substituting "August 31, 1986" for "August 15, 1986" each place it appears,

(B) subsection (b)(1) shall be applied without regard to subparagraphs (F), (G), and (J), and

(C) such bond shall not be treated as a private activity bond for purposes of applying the requirements referred to in subparagraphs (H) and (I) of subsection (b)(1).

(2) Bond described.—A bond is described in this paragraph if such bond is not—

(A) an industrial development bond, as defined in section 103(b)(2) of the 1954 Code but determined—

(i) by inserting "directly or indirectly" after "is" in the material preceding clause (i) of subparagraph (B) thereof, and

(ii) without regard to subparagraph (B) of section 103(b)(3) of such Code,

(B) a mortgage subsidy bond (as defined in section 103A(b)(1) of such Code, without regard to any exception from such definition), or

(C) a private loan bond (as defined in section 103(o)(2)(A) of such Code, without regard to any exception from such definition other than section 103(o)(2)(C) of such Code).

(d) Election Out.—This section shall not apply to any issue with respect to which the issuer elects not to have this section apply.

SEC. 1313. TRANSITIONAL RULES RELATING TO REFUNDINGS.

(a) Certain Current Refundings.—

(1) In general.—Except as provided in paragraph (3), the amendments made by section 1301 shall not apply to any bond the proceeds of which are used exclusively to refund (other than to advance refund) a qualified bond (or a bond which is part of a series of refundings of a qualified bond) if—

(A) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

(B)(i) the average maturity of the issue of which the refunding bond is a part does not exceed 120 percent of the average reasonably expected economic life of the facilities being financed with the proceeds of such issue (determined under section 147(b) of the 1986 Code), or

(ii) the refunding bond has a maturity date not later than the date which is 17 years after the date on which the qualified bond was issued.

In the case of a qualified bond which was (when issued) a qualified mortgage bond or a qualified veterans' mortgage bond, subparagraph (B)(i) shall not apply and subparagraph (B)(ii) shall be applied by substituting "32 years" for "17 years".

(2) QUALIFIED BOND.—For purposes of paragraph (1), the term "qualified bond" means any bond (other than a refunding bond)—

(A) issued before August 16, 1986, or

(B) issued after August 15, 1986, if section 1312(a) applies to such bond.

(3) CERTAIN AMENDMENTS TO APPLY.—The following provisions of the 1986 Code shall be treated as included in section 103 and section 103A (as appropriate) of the 1954 Code and shall apply to refunding bonds described in paragraph (1):

(A) The requirements of section 147(f) (relating to public approval required for private activity bonds) but only if the maturity date of the refunding bond is later than the maturity date of the refunded bond.

(B) The requirements of section 147(g) (relating to restriction on issuance costs financed by issue).

(C) The requirements of section 148 (relating to arbitrage).

(D) The requirements of section 149(e) (relating to information reporting).

(E) The provisions of section 150(b) of such Code (relating to changes in use).

Subparagraphs (A) and (D) shall apply only if the refunding bond is issued after December 31, 1986.

(4) SPECIAL RULES FOR CERTAIN GOVERNMENT BONDS ISSUED AFTER AUGUST 15, 1986.—In the case of any bond described in section 1312(c)(2)—

(A) paragraph (2) of this subsection shall be applied by substituting "August 31, 1986" for "August 15, 1986",

(B) paragraph (3) shall be applied without regard to subparagraphs (A), (B), and (E), and

(C) such bond shall not be treated as a private activity bond for purposes of applying the requirements referred to in subparagraphs (C) and (D) of paragraph (3).

(b) CERTAIN ADVANCE REFUNDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (3), the amendments made by section 1301 shall not apply to any bond the proceeds of which are used exclusively to advance refund a bond if—

(A) the refunded bond is described in paragraph (2), and

(B) the requirements of subsection (a)(1)(B) are met.

(2) NON-IDB'S, ETC.—A bond is described in this paragraph if such bond is not described in subsection (b)(2) or (o)(2)(A) of section 103 of the 1954 Code and was issued (or was issued to refund a bond issued) before August 16, 1986.

(3) CERTAIN AMENDMENTS TO APPLY.—The following provisions of the 1986 Code shall be treated as included in section

103 and section 103A (as appropriate) of the 1954 Code and shall apply to refunding bonds described in paragraph (1):

(A) The requirements of section 147(f) (relating to public approval required for private activity bonds).

(B) The requirements of section 147(g) (relating to restriction on issuance costs financed by issue).

(C) The requirements of section 148 (relating to arbitrage), except that section 148(d)(3) shall not apply to proceeds of such bonds to be used to discharge the refunded bonds.

(D) The requirements of paragraphs (3) and (4) of section 149(d) (relating to advance refundings).

(E) The requirements of section 149(e) (relating to information reporting).

(F) The provisions of section 150(b) of such Code (relating to changes in use).

Subparagraphs (A) and (E) shall apply only if the refunding bond is issued after December 31, 1986.

(4) SPECIAL RULE FOR CERTAIN GOVERNMENT BONDS ISSUED AFTER AUGUST 15, 1986.—In the case of any bond described in section 1312(c)(2)—

(A) paragraph (2) of this subsection shall be applied by substituting "September 1, 1986" for "August 16, 1986",

(B) paragraph (3) shall be applied without regard to subparagraphs (A), (B), and (F), and

(C) such bond shall not be treated as a private activity bond for purposes of applying the requirements referred to in subparagraphs (C) and (E).

(5) CERTAIN REFUNDING BONDS SUBJECT TO VOLUME CAP.—Any refunding bond described in paragraph (1) the proceeds of which are used to refund a bond issued as part of an issue 5 percent or more of the net proceeds of which are to be used to provide an output facility (within the meaning of section 141(b)(4) of the 1986 Code) shall be treated as a private activity bond for purposes of section 146 of the 1986 Code (to the extent of the nongovernmental use of such issue, under rules similar to the rules of section 146(m)(2) of such Code). For purposes of the preceding sentence, use by a 501(c)(3) organization with respect to its activities which do not constitute unrelated trades or businesses (determined by applying section 513(a) of the 1986 Code) shall not be taken into account.

(c) TREATMENT OF CURRENT REFUNDINGS OF CERTAIN IDB'S AND 501(c)(3) BONDS.—

(1) $40,000,000 LIMIT FOR CERTAIN SMALL ISSUE BONDS.—Paragraph (10) of section 144(a) of the 1986 Code shall not apply to any bond the proceeds of which are used exclusively to refund a tax-exempt bond to which such paragraph and the corresponding provision of prior law do not apply if—

(A) the refunding bond has a maturity date not later than the maturity date of the refunded bond,

(B) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond,

(C) the interest rate on the refunding bond is lower than the interest rate on the refunded bond, and

(D) the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond.

(2) $150,000,000 LIMITATION FOR CERTAIN 501(c)(3) BONDS.—Subsection (b) of section 145 of the 1986 Code (relating to $150,000,000 limitation for nonhospital bonds) shall not apply to any bond the proceeds of which are used exclusively to refund a tax-exempt bond to which such subsection does not apply if—

(A)(i) the average maturity of the issue of which the refunding bond is a part does not exceed 120 percent of the average reasonably expected economic life of the facilities being financed with the proceeds of such issue (determined under section 147(b) of the 1986 Code), or

(ii) the refunding bond has a maturity date not later than the later of the date which is 17 years after the date on which the qualified bond (as defined in subsection (a)(2)) was issued, and

(B) the requirements of subparagraphs (B) and (D) of paragraph (1) are met with respect to the refunding bond. Subsection (b) of section 145 of the 1986 Code shall not apply to the 1st advance refunding after March 14, 1986, of a bond issued before January 1, 1986.

(3) APPLICATION TO LATER ISSUES.—Any bond to which section 144(a)(10) or 145(b) of the 1986 Code does not apply by reason of this section shall be taken into account in determining whether such section applies to any later issue.

SEC. 1314. SPECIAL RULES WHICH OVERRIDE OTHER RULES IN THIS SUBTITLE.

(a) ARBITRAGE RESTRICTION ON INVESTMENTS IN ANNUITIES.—In the case of a bond issued after September 25, 1985, section 103(c) of the 1954 Code shall be applied by treating the reference to securities in paragraph (2) thereof as including a reference to an annuity contract.

(b) TEMPORARY PERIOD FOR ADVANCE REFUNDINGS.—In the case of a bond issued after December 31, 1985, to advance refund a bond, the initial temporary period under section 103(c) of the 1954 Code with respect to the proceeds of the refunding bond shall end not later than 30 days after the date of issue of the refunding bond.

(c) DETERMINATION OF YIELD.—In the case of a bond issued after December 31, 1985, for purposes of section 103(c) of the 1954 Code, the yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274 of the 1986 Code).

(d) ARBITRAGE REBATE REQUIREMENT.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, in the case of a bond issued after December 31, 1985, section 103 of the 1954 Code shall be treated as including the requirements of section 148(f) of the 1986 Code in order for section 103(a) of the 1954 Code to apply.

(2) GOVERNMENT BONDS.—In the case of a bond described in section 1312(c)(2) (and not described in paragraph (3) of this

subsection), paragraph (1) shall be applied by substituting "August 31, 1986" for "December 31, 1985".

(3) CERTAIN POOLS.—

(A) IN GENERAL.—In the case of a bond described in section 1312(c)(2) and issued as part of an issue described in subparagraph (B), (C), (D), or (E), paragraph (1) shall be applied by substituting "3 p.m. E.D.T., July 17, 1986" for "December 31, 1985". Such a bond shall not be treated as a private activity bond for purposes of applying section 148(f) of the 1986 Code.

(B) LOANS TO UNRELATED GOVERNMENTAL UNITS.—An issue is described in this subparagraph if any portion of the proceeds of the issue is to be used to make or finance loans to any governmental unit other than any governmental unit which is subordinate to the issuer and the jurisdiction of which is within—

(i) the jurisdiction of the issuer, or

(ii) the jurisdiction of the governmental unit on behalf of which such issuer issued the issue.

(C) LESS THAN 75 PERCENT OF PROJECTS IDENTIFIED.—An issue is described in this subparagraph if less than 75 percent of the proceeds of the issue is to be used to make or finance loans to initial borrowers to finance projects identified (with specificity) by the issuer, on or before the date of issuance of the issue, as projects to be financed with the proceeds of the issue.

(D) LESS THAN 25 PERCENT OF FUNDS COMMITTED TO BE BORROWED.—An issue is described in this subparagraph if, on or before the date of issuance of the issue, commitments have not been entered into by initial borrowers to borrow at least 25 percent of the proceeds of the issue.

(E) CERTAIN LONG MATURITY ISSUES.—An issue is described in this subparagraph if—

(i) the maturity date of any bond issued as part of such issue exceeds 30 years, and

(ii) any principal payment on any loan made or financed by the proceeds of the issue is to be used to make or finance additional loans.

(F) SPECIAL RULES.—

(i) EXCEPTION FROM SUBPARAGRAPHS (C) AND (D) WHERE SIMILAR POOLS ISSUED BY ISSUER.—An issue shall not be treated as described in subparagraph (C) or (D) with respect to any issue to make or finance loans to governmental units if—

(I) the issuer, before 1986, issued 1 or more similar issues to make or finance loans to governmental units, and

(II) the aggregate face amount of such issues issued during 1986 does not exceed 250 percent of the average of the annual aggregate face amounts of such similar issues issued during 1983, 1984, or 1985.

(ii) DETERMINATION OF ISSUANCE.—For purposes of subparagraph (A), an issue shall not be treated as issued until—

(I) the bonds issued as part of such issue are offered to the public (pursuant to final offering materials), and

(II) at least 25 percent of such bonds is sold to the public.

For purposes of the preceding sentence, the sale of a bond to a securities firm, broker, or other person acting in the capacity of an underwriter or wholesaler shall not be treated as a sale to the public.

(e) INFORMATION REPORTING.—In the case of a bond issued after December 31, 1986, nothing in section 103(a) of the 1986 Code or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond unless such bond satisfies the requirements of section 149(e) of the 1986 Code. A bond described in section 1312(c)(2) shall not be treated as a private activity bond for purposes of applying such requirements.

(f) ABUSIVE TRANSACTION LIMITATION ON ADVANCE REFUNDINGS TO APPLY.—In the case of a bond issued after December 31, 1986, nothing in section 103(a) of the 1986 Code or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond if the issue of which such bond is a part is described in paragraph (4) of section 149(d) of the 1986 Code (relating to abusive transactions).

(g) SECTION TO OVERRIDE OTHER RULES.—Except as otherwise expressly provided by reference to a provision to which a subsection of this section applies, nothing in any other section of this subtitle shall be construed as exempting any bond from the application such provision.

SEC. 1315. TRANSITIONAL RULES RELATING TO VOLUME CAP.

(a) IN GENERAL.—Except as otherwise provided in this section, section 146(f) of the 1986 Code shall not apply with respect to an issuing authority's volume cap under section 103(n) of the 1954 Code, and no carryforward under such section 103(n) shall be recognized for bonds issued after August 15, 1986.

(b) CERTAIN BONDS FOR CARRYFORWARD PROJECTS OUTSIDE OF VOLUME CAP.—Bonds issued pursuant to an election under section 103(n)(10) of the 1954 Code (relating to elective carryforward of unused limitation for specified project) made before November 1, 1985, shall not be taken into account under section 146 of the 1986 Code if the carryforward project is a facility to which the amendments made by section 1301 do not apply by reason of section 1312(a) of this Act.

(c) VOLUME CAP NOT TO APPLY WITH RESPECT TO CERTAIN FACILITIES AND PURPOSES.—Section 146 of the 1986 Code shall not apply to any bond issued with respect to any facility or purpose described in a paragraph of subsection (d) if—

(1) such bond would not have been taken into account under section 103(n) of the 1954 Code (determined without regard to any carryforward election) were such bond issued before August 16, 1986, or

(2) such bond would not have been taken into account under section 103(n) of the 1954 Code (determined with regard to any carryforward election made before January 1, 1986) were such bond issued before August 16, 1986.

(d) FACILITIES AND PURPOSES DESCRIBED.—

(1) A facility is described in this paragraph if the amendments made by section 201 of this Act (relating to depreciation) do not apply to such facility by reason of section 204(a)(8) of this Act (or, in the case of a facility which is governmentally owned, would not apply to such facility were it owned by a nongovernmental person).

(2) A facility or purpose is described in this paragraph if the facility or purpose is described in a paragraph of section 1317.

(3) A facility is described in this paragraph if the facility—

(A) serves Los Osos, California, and

(B) would be described in paragraph (1) were it a solid waste disposal facility.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $35,000,000.

(4) A facility is described in this paragraph if it is a sewage disposal facility with respect to which—

(A) on September 13, 1985, the State public facilities authority took official action authorizing the issuance of bonds for such facility, and

(B) on December 30, 1985, there was an executive order of the State Governor granting allocation of the State ceiling under section 103(n) of the 1954 Code in the amount of $250,000,000 to the Industrial Development Board of the Parish of East Baton Rouge, Louisiana.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $98,500,000.

(5) A facility is described in this paragraph if—

(A) such facility is a solid waste disposal facility in Charleston, South Carolina, and

(B) a State political subdivision took formal action on April 1, 1980, to commit development funds for such facility.

For purposes of determining whether a bond issued as part of an issue for a facility described in the preceding sentence is an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code, "90 percent" shall be substituted for "95 percent" in section 142(a) of the 1986 Code.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $75,000,000.

(6) A facility is described in this paragraph if—

(A) such facility is a wastewater treatment facility for which site preparation commenced before September 1985, and

(B) a parish council approved a service agreement with respect to such facility on December 4, 1985.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $120,000,000.

(e) TREATMENT OF REDEVELOPMENT BONDS.—Any bond to which section 1317(6) of this Act applies shall be treated for purposes of this section as described in subsection (c)(1).

SEC. 1316. PROVISIONS RELATING TO CERTAIN ESTABLISHED STATE PROGRAMS.

(a) CERTAIN LOANS TO VETERANS FOR THE PURCHASE OF LAND.—

(1) IN GENERAL.—A bond described in paragraph (2) shall be treated as described in section 141(d)(1) of the 1986 Code, but subsections (a), (b), (c), and (d) of section 147 of such Code shall not apply to such bond.

(2) BOND DESCRIBED.—A bond is described in this paragraph if—

(A) such bond is a private activity bond solely by reason of section 141(c) of such Code, and

(B) such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to carry out a program established under State law to provide loans to veterans for the purchase of land and which has been in effect in substantially the same form during the 30-year period ending on July 18, 1984, but only if such proceeds are used to make loans or to fund similar obligations—

(i) in the same manner in which,

(ii) in the same (or lesser) amount or multiple of acres per participant, and

(iii) for the same purposes for which,

such program was operated on March 15, 1984.

(b) RENEWABLE ENERGY PROPERTY.—

(1) IN GENERAL.—A bond described in paragraph (2) shall be treated as described in section 141(d)(1) of the 1986 Code.

(2) BOND DESCRIBED.—A bond is described in this paragraph if paragraph (1) of section 103(b) of the 1954 Code would not (without regard to the amendments made by this title) have applied to such bond by reason of section 243 of the Crude Oil Windfall Profit Tax Act of 1980 if—

(A) such section 243 were applied by substituting "95 percent or more of the net proceeds" for "substantially all of the proceeds" in subsection (a)(1) thereof, and

(B) subparagraph (E) of subsection (a)(1) thereof referred to section 149(b) of the 1986 Code.

(c) CERTAIN STATE PROGRAMS.—

(1) IN GENERAL.—A bond described in paragraph (2) shall be treated as described in section 141(d)(1) of the 1986 Code.

(2) BOND DESCRIBED.—A bond is described in this paragraph if such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to carry out a program established under sections 280A, 280B, and 280C of the Iowa Code, but only if—

(A) such program has been in effect in substantially the same form since July 1, 1983, and

(B) such proceeds are to be used to make loans or fund similar obligations for the same purposes as permitted under such program on July 1, 1986.

(3) $100,000,000 limitation.—The aggregate face amount of outstanding bonds to which this subsection applies shall not exceed $100,000,000.

(d) Use by Certain Federal Instrumentalities Treated as Use by Governmental Units.—Use by an instrumentality of the United States shall be treated as use by a State or local governmental unit for purposes of section 103, and part IV of subchapter B of chapter 1, of the 1986 Code with respect to a program approved by Congress before August 3, 1972, but only if—

(1) a portion of such program has been financed by bonds issued before such date, to which section 103(a) of the 1954 Code applied pursuant to a ruling issued by the Commissioner of the Internal Revenue Service, and

(2) construction of 1 or more facilities comprising a part of such program commenced before such date.

(e) 1 Refunding Permitted of Certain Bonds Invested in Federally Insured Deposits.—

(1) In general.—Section 149(b)(2)(B)(ii) of the 1986 Code shall not apply to any bond issued to refund a bond—

(A) which, when issued, would have been treated as federally guaranteed by reason of being described in clause (ii) of section 103(h)(2)(B) of the 1954 Code if such section had applied to such bond, and

(B)(i) which was issued before April 15, 1983, or

(ii) to which such clause did not apply by reason of the except clause in section 631(c)(2) of the Tax Reform Act of 1984.

Section 147(c) of the 1986 Code shall not apply to any refunding bond permitted under the preceding sentence if section 103(b)(16) of the 1954 Code did not apply to the refunded bond when issued.

(2) Requirements.—A refunding bond meets the requirements of this paragraph if—

(A) the refunding bond has a maturity date not later than the maturity date of the refunded bond,

(B) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond,

(C) the weighted average interest rate on the refunding bond is lower than the weighted average interest rate on the refunded bond, and

(D) the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond.

(f) Certain Hydroelectric Generating Property.—

(1) In general.—A bond described in paragraph (2) shall be treated as described in section 141(d)(1) of the 1986 Code.

(2) Description.—A bond is described in this paragraph if such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide a facility described in section 103(b)(4)(H) of the 1954 Code determined—

(A) by substituting "an application for a license" for "an application" in section 103(b)(8)(E)(ii) of the 1954 Code, and

(B) by applying the requirements of section 142(b)(2) of the 1986 Code.

(g) TREATMENT OF BONDS SUBJECT TO TRANSITIONAL RULES UNDER TAX REFORM ACT OF 1984.—

(1) Subsections (d)(3) and (f) of section 148 of the 1986 Code shall not apply to any bond described in section 624(c)(2) of the Tax Reform Act of 1984.

(2)(A) There shall not be taken into account under section 146 of the 1986 Code any bond described in the paragraph (3) of section 631(a) of the Tax Reform Act of 1984 relating to exception for certain bonds for a convention center and resource recovery project.

(B) If a bond issued as part of an issue substantially all of the proceeds of which are used to provide the convention center to which such paragraph (3) applies, such bond shall be treated as an exempt facility bond as defined in section 142(a) of the 1986 Code.

(C) If a bond which is issued as part of an issue substantially all of the proceeds of which are used to provide the resource recovery project to which paragraph (3) applies, such bond shall be treated as an exempt facility bond as defined in section 142(a) of the 1986 Code and section 149(b) of such Code shall not apply.

(3) The amendments made by section 1301 shall not apply to bonds issued to finance any property described in section 631(d)(4) of the Tax Reform Act of 1984.

(4) The amendments made by section 1301 shall not apply to—

(A) any bond issued to finance property described in section 631(d)(5) of the Tax Reform Act of 1984,

(B) any bond described in paragraph (2), (3), (4), (5), (6), or (7) of section 632(a), or section 632(b), of such Act, and

(C) any bond to which section 632(g)(2) of such Act applies.

In the case of bonds to which this paragraph applies, the requirements of sections 148 and 149(d) shall be treated as included in section 103 of the 1954 Code and shall apply to such bonds.

(5) The preceding provisions of this subsection shall not apply to any bond issued after December 31, 1988.

(6) The amendments made by section 1301 shall not apply to any bond issued to finance property described in section 216(b)(3) of the Tax Equity and Fiscal Responsibility Act of 1982.

(7) In the case of a bond described in section 632(d) of the Tax Reform Act of 1984—

(A) section 141 of the 1986 Code shall be applied without regard to subsection (a)(2) and subsection (b)(5) and paragraphs (1) and (2) of subsection (b) thereof shall be applied by substituting "25 percent" for "10 percent" each place it appears, and

(B) section 149(b) of the 1986 Code shall not apply.

(8)(A) The amendments made by section 1301 shall not apply to any bond to which section 629(a)(1) of the Tax Reform Act of 1984 applies, but such bond shall be treated as a private activity bond for purposes of section 146 of the 1986 Code.

(B) Section 629 of the Tax Reform Act of 1984 is amended—

(i) in subsection (c)(2), by striking out "$625,000,000" and inserting in lieu thereof "$911,000,000",

(ii) in subsection (c)(3), by adding at the end thereof the following new subparagraphs:

"(D) Improvements to existing generating facilities.

"(E) Transmission lines.

"(F) Electric generating facilities.", and

(iii) in subsection (a), by adding at the end thereof the following new sentence: "The preceding sentence shall be applied by inserting 'and a rural electric cooperative utility' after 'regulated public utility' but only if not more than 1 percent of the load of the public power authority is sold to such rural electric cooperative utility."

(h) Certain Pollution Bonds.—Any bond which is treated as described in section 103(b)(4)(F) of the 1954 Code by reason of section 13209 of the Consolidated Omnibus Budget Reconciliation Act of 1985 shall be treated as a exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code, and section 147(d) of the 1986 Code shall not apply to such bond.

(i) Transition Rule for Aggregate Limit per Taxpayer.—For purposes of section 144(a)(10) of the 1986 Code, tax increment bonds described in section 1869(c)(3) of this Act which are issued before August 16, 1986, shall not be taken into account under subparagraph (B)(ii) thereof.

(j) Extension of Advance Refunding Exception for Qualified Public Facility.—Paragraph (4) of section 631(c) of the Tax Reform Act of 1984 is amended—

(1) by striking out "or the Dade County, Florida, airport" in the last sentence, and

(2) by adding at the end thereof the following new sentence: "In the case of refunding obligations not to exceed $40,000,000 with respect to the Dade County, Florida, airport, the first sentence of this paragraph shall be applied by substituting 'December 31, 1987' for 'December 31, 1984' and the amendments made by section 1301 of the Tax Reform Act of 1986 shall not apply."

(k) Expansion of Exception for River Place Project.—Section 1104 of the Mortgage Subsidy Bond Tax Act of 1980, as added by the Tax Reform Act of 1984, is amended—

(1) by striking out "December 31, 1984," in subsection (p) and inserting in lieu thereof "December 31, 1984 (other than obligations described in subsection (r)(1)),", and

(2) by striking out "$55,000,000," in subsection (r)(1)(B) and inserting in lieu thereof "$110,000,000 of which $55,000,000 must be redeemed no later than November 1, 1987".

(l) Certain Refundings.—Section 628(g) of the Tax Reform Act of 1984 (and the amendments made by section 1301 of this Act) shall not apply to any refunding obligation if the refunded issue was approved by a city building commission on April 29, 1982, and was issued on May 11, 1982, and the refunding obligations were issued before January 1, 1987.

SEC. 1317. TRANSITIONAL RULES FOR SPECIFIC FACILITIES.

(1) DOCKS AND WHARVES.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide any dock or wharf (within the meaning of section 103(b)(4)(D) of the 1954 Code) shall be treated as an exempt facility bond (for a facility described in section 142(a)(2) of the 1986 Code) for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such dock or wharf is described in any of the following subparagraphs:

(A) A dock or wharf is described in this subparagraph if—

(i) the issue to finance such dock or wharf was approved by official city action on September 3, 1985, and by voters on November 5, 1985, and

(ii) such dock or wharf is for a slack water harbor with respect to which a Corps of Engineers grant of approximately $2,000,000 has been made under section 107 of the Rivers and Harbors Act.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $2,500,000.

(B) A dock or wharf is described in this subparagraph if—

(i) inducement resolutions were adopted on May 23, 1985, September 18, 1985, and September 24, 1985, for the issuance of the bonds to finance such dock or wharf,

(ii) a harbor dredging contract with respect thereto was entered into on August 2, 1985, and

(iii) a construction management and joint venture agreement with respect thereto was entered into on October 1, 1984.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $625,000,000.

(C) A facility is described in this subparagraph if—

(i) the legislature first authorized on June 29, 1981, the State agency issuing the bond to issue at least $30,000,000 of bonds,

(ii) the developer of the facility was selected on April 26, 1985, and

(iii) an inducement resolution for the issuance of such issue was adopted on October 9, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(D) A facility is described in this subparagraph if—

(i) an inducement resolution was adopted on October 17, 1985, for such issue, and

(ii) the city council for the city in which the facility is to be located approved on July 30, 1985, an application for an urban development action grant with respect to such facility.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $36,500,000. A facility shall be treated as described in this subparagraph if it would be so described if "90 percent" were substituted for "95 per-

cent" in the material preceding subparagraph (A) of this paragraph.

(2) Pollution control facilities.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide air or water pollution control facilities (within the meaning of section 103(b)(4)(C) of the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facility is described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if—

(i) inducement resolutions with respect to such facility were adopted on September 23, 1974, and on April 5, 1985,

(ii) a bond resolution for such facility was adopted on September 6, 1985, and

(iii) the issuance of the bonds to finance such facility was delayed by action of the Securities and Exchange Commission (file number 70-7127).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $120,000,000.

(B) A facility is described in this subparagraph if—

(i) there was an inducement resolution for such facility on November 19, 1985, and

(ii) design and engineering studies for such facility were completed in March of 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $25,000,000.

(C) A facility is described in this subparagraph if—

(i) a resolution was adopted by the county board of supervisors pertaining to an issuance of bonds with respect to such facility on April 10, 1974, and

(ii) such facility was placed in service on June 12, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $90,000,000. For purposes of this subparagraph, a pollution control facility includes a sewage or solid waste disposal facility (within the meaning of section 103(b)(4)(E) of the 1954 Code).

(D) A facility is described in this subparagraph if—

(i) the issuance of the bonds for such facility was approved by a State agency on August 22, 1979, and

(ii) the authority to issue such bonds was scheduled to expire (under terms of the State approval) on August 22, 1989.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $198,000,000.

(E) A facility is described in this subparagraph if—

(i) such facility is 1 of 4 such facilities in 4 States with respect to which the Ball Corporation transmitted a letter of intent to purchase such facilities on February 26, 1986, and

(ii) inducement resolutions were issued on December 30, 1985, January 15, 1986, January 22, 1986, and

March 17, 1986 with respect to bond issuance in the 4 respective States.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $6,000,000.

(F) A facility is described in this subparagraph if—

(i) inducement resolutions for bonds with respect to such facility were adopted on September 27, 1977, May 27, 1980, and October 8, 1981, and

(ii) such facility is located at a geothermal power complex owned and operated by a single investor-owned utility.

For purposes of this subparagraph and section 103 of the 1986 Code, all hydrogen sulfide air and water pollution control equipment, together with functionally related and subordinate equipment and structures, located or to be located at such power complex shall be treated as a single pollution control facility. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $600,000,000.

(G) A facility is described in this subparagraph if—

(i) such facility is an air pollution control facility approved by a State bureau of pollution control on July 10, 1986, and by a State board of economic development on July 17, 1986, and

(ii) on August 15, 1986, the State bond attorney gave notice to the clerk to initiate validation proceedings with respect to such issue and on August 28, 1986, the validation decree was entered.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $900,000.

(I) A facility is described in this subparagraph if—

(i) a private company met with a State air control board on November 14, 1985, to propose construction of a sulften unit, and

(ii) the sulften unit is being constructed under a letter of intent to construct which was signed on April 8, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $11,000,000.

(J) A facility is described in this subparagraph if it is part of a 250 megawatt coal-fired electric plant in northeastern Nevada on which the Sierra Pacific Power Company began construction in 1980. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(K) A facility is described in this subparagraph if—

(i) there was an inducement resolution adopted by a State industrial development authority on January 14, 1976, and

(ii) such facility is named in a resolution of such authority relating to carryforward of the State's unused 1985 private activity bond limit passed by such industrial development authority on December 18, 1985.

This subparagraph shall apply only to obligations issued at the request of the party pursuant to whose request the January 14, 1976, inducement was given. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(L) A facility is described in this subparagraph if a city council passed an ordinance (ordinance number 4626) agreeing to issue bonds for such project, December 16, 1985. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $45,000,000.

(3) SPORTS FACILITIES.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide sports facilities (within the meaning of section 103(b)(4)(B) of the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facilities are described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if it is a domed stadium—

(i) which was the subject of a city ordinance passed on September 23, 1985,

(ii) for which a loan of approximately $4,000,000 for land acquisition was approved on October 28, 1985, by the State Controlling Board, and

(iii) a stadium operating corporation with respect to which was incorporated on March 20, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(B) A facility is described in this subparagraph if—

(i) it is a stadium with respect to which a lease agreement for the ground on which the stadium is to be built was entered into between a county and the stadium corporation for such stadium on July 3, 1984,

(ii) there was a resolution approved on November 14, 1984, by an industrial development authority setting forth the terms under which the bonds to be issued to finance such stadium would be issued, and

(iii) there was an agreement for consultant and engineering services for such stadium entered into on September 28, 1984.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $90,000,000.

(C) A facility is described in this subparagraph if—

(i) it is a stadium to be used by an American League baseball team currently using a stadium in a city having a population in excess of 2,500,000 and described in section 146(d)(3) of the 1986 Code, or by one or more professional sports teams currently using stadiums in such city (or professional sports teams which locate in such city following the relocation from such city of one or more professional sports teams currently using one or more of such stadiums), and

(ii) the obligations to be used to provide financing for such stadium are issued pursuant to an inducement

resolution adopted by a State agency on November 20, 1985 (whether or not the beneficiary of such issue is the beneficiary (if any) specified in such resolution).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $250,000,000. In the case of a carryforward of volume cap for a stadium described in the first sentence of this subparagraph, such carryforward shall be permitted whether or not there is a change in the beneficiary of the project.

(D) A facility is described in this subparagraph if—

(i) such facility is a stadium or sports arena for Memphis, Tennessee,

(ii) there was an inducement resolution adopted on November 12, 1985, for the issuance of bonds to expand or renovate an existing stadium and sports arena and/or to construct a new arena, and

(iii) the city council for such city adopted a resolution on April 19, 1983, to include funds in the capital budget of the city for such facility or facilities.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $35,000,000.

(E) A facility is described in this subparagraph if such facility is a baseball stadium located in Bergen, Essex, Union, Middlesex, or Hudson County, New Jersey with respect to which governmental action occurred on November 7, 1985. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $150,000,000.

(F) A facility is described in this subparagraph if—

(i) it is a facility with respect to which—

(I) an inducement resolution dated December 24, 1985, was adopted by the county industrial development authority,

(II) a public hearing of the county industrial development authority was held on February 6, 1986, regarding such facility, and

(III) a contract was entered into by the county, dated February 19, 1986, for engineering services for a highway improvement in connection with such project, or

(ii) it is a domed football stadium adjacent to Cervantes Convention Center in St. Louis, Missouri, with respect to which a proposal to evaluate market demand, financial operations, and economic impact was dated May 9, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $175,000,000.

(G) A project to provide a roof or dome for an existing sports facility is described in this subparagraph if—

(i) in December 1984 the county sports complex authority filed a carryforward election under section 103(n) of the 1954 Code with respect to such project,

(ii) in January 1985, the State authorized issuance of $30,000,000 in bonds in the next 3 years for such project, and

(iii) an 11-member task force was appointed by the county executive in June 1985, to further study the feasibility of the project.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $30,000,000.

(H) A sports facility renovation or expansion project is described in this subparagraph if—

(i) an amendment to the sports team's lease agreement for such facility was entered into on May 23, 1985, and

(ii) the lease agreement had previously been amended in January 1976, on July 6, 1984, on April 1, 1985, and on May 7, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $20,000,000.

(I) A facility is described in this subparagraph if—

(i) an appraisal for such facility was completed on March 6, 1985,

(ii) an inducement resolution was adopted with respect to such facility on June 7, 1985, and

(iii) a State bond commission granted preliminary approval for such project on September 3, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $3,200,000.

(J) A sports facility renovation or expansion project is described in this subparagraph if—

(i) such facility is a domed stadium which commenced operations in 1965,

(ii) such facility has been the subject of an ongoing construction, expansion, or renovation program of planned improvements,

(iii) part 1 of such improvements began in 1982 with a preliminary renovation program financed by tax-exempt bonds,

(iv) part 2 of such program was previously scheduled for a bond election on February 25, 1986, pursuant to a Commissioners Court Order of October 29, 1985, and

(v) the bond election for improvements to such facility was subsequently postponed on December 10, 1985, in order to provide for more comprehensive construction planning.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(K) A facility is described in this subparagraph if—

(i) the 1985 State legislature appropriated a maximum sum of $22,500,000 to the State urban development corporation to be made available for such project, and

(ii) a development and operation agreement was entered into among such corporation, the city, the State budget director, and the county industrial development agency, as of March 1, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $28,000,000.

(L) A facility is described in this subparagraph if—

(i) it is to consist of 1 or 2 stadiums appropriate for football games and baseball games with related structures and facilities,

(ii) governmental action was taken on August 7, 1985, by the county commission, and on December 19, 1985, by the city council, concerning such facility, and

(iii) such facility is located in a city having a National League baseball team.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(M) A facility is described in this subparagraph if—

(i) such facility consists of 1 or 2 stadium projects (1 of which may be a stadium renovation or expansion project) with related structures and facilities,

(ii) a special advisory commission commissioned a study by a national accounting firm with respect to a project for such facility, which study was released in September 1985, and recommended construction of either a new multipurpose or a new baseball-only stadium,

(iii) a nationally recognized design and architectural firm released a feasibility study with respect to such project in April 1985, and

(iv) the metropolitan area in which the facility is located is presently the home of an American League baseball team.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(N) A facility is described in this subparagraph if—

(i) it is to consist of 1 or 2 stadiums appropriate for football games and baseball games with related structures and facilities,

(ii) the site for such facility was approved by the council of the city in which such facility is to be located on July 9, 1985, and

(iii) the request for proposals process was authorized by the council of the city in which such facility is to be located on November 5, 1985, and such requests were distributed to potential developers on November 15, 1985, with responses due by February 14, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(O) A facility is described in this subparagraph if—

(i) such facility is described in a feasibility study dated September 1985, and

(ii) resolutions were adopted or other actions taken on February 21, 1985, July 18, 1985, August 8, 1985, October 17, 1985, and November 7, 1985, by the Board of Supervisors of the county in which such facility will be located with respect to such feasibility study, appropriations to obtain land for such facility, and approving the location of such facility in the county.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $20,000,000.

(P) A facility is described in this subparagraph if such facility constructed on a site acquired with the sale of revenue bonds approved by a city council on December 9, 1985, (Ordinances No. 669 and 670, series 1985). The aggregate face amount of bonds to which this subparagraph applies shall not exceed $90,000,000.

(Q) A facility is described in this subparagraph if—

(i) resolutions were adopted approving a ground lease dated June 27, 1983, by a sports authority (created by a State legislature) with respect to the land on which the facility will be erected,

(ii) such facility is described in a market study dated June 13, 1983, and

(iii) such facility was the subject of an Act of the State legislature which was signed on July 1, 1983.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $81,000,000.

(R) A facility is described in this subparagraph if such facility is a baseball stadium and adjacent parking facilities with respect to which a city made a carryforward election of $52,514,000 on February 25, 1985. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $50,000,000.

(S) A facility is described in this subparagraph if—

(i) such facility is to be used by both a National Hockey League team and a National Basketball Association team,

(ii) such facility is to be constructed on a platform using air rights over land acquired by a State authority and identified as site B in a report dated May 30, 1984, prepared for a State urban development corporation, and

(iii) such facility is eligible for real property tax (and power and energy) benefits pursuant to State legislation approved and effective as of July 7, 1982.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $225,000,000.

(T) A facility is described in this subparagraph if—

(i) a resolution authorizing the financing of the facility through an issuance of revenue bonds was adopted by the City Commission on August 5, 1986, and

(ii) the metropolitan area in which the facility is to be located is currently the spring training home of an American league baseball team located during the regular season in a city described in subparagraph (C).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $10,000,000.

(U) A facility is described in this subparagraph if it is a football stadium located in Oakland, California, with respect to which a design was completed by a nationally recognized architectural firm for a stadium seating approximately 72,000, to be located on property adjacent to an ex-

isting coliseum complex. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $100,000,000.

(V) A facility is described in this subparagraph if it is a sports arena (and related parking facility) for Grand Rapids, Michigan. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $80,000,000.

(W) A facility is described in this subparagraph if such facility is located adjacent to the Anacostia River in the District of Columbia. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $225,000,000.

(X) A facility is described in this subparagraph if it is a spectator sports facility for the City of San Antonio, Texas. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $125,000,000.

(Y) A facility is described in this subparagraph is it will be part of, or adjacent to, an existing stadium which has been owned and operated by a State university and if—

(i) the stadium was the subject of a feasibility report by a certified public accounting firm which is dated December 28, 1984, and

(ii) a report by an independent research organization was prepared in December 1985 demonstrating support among donors and season ticket holders for the addition of a dome to the stadium.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $50,000,000.

(4) Residential rental property.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to finance a residential rental project within the meaning of section 103(b)(4) of the 1954 Code shall be treated as an exempt facility bond within the meaning of section 142(a)(7) of the 1986 Code if the facility with respect to the bond is issued satisfies all low-income occupancy requirements applicable to such bonds before August 15, 1986. The bonds are issued pursuant to—

(A) a contract to purchase such property dated August 12, 1985; and

(B) the county housing authority approved the property and the financing thereof on September 24, 1985,

(C) there was an inducement resolution adopted on October 10, 1985, by the county industrial development authority.

aggregate face amount of bonds to which this paragraph applies shall not exceed $25,400,000.

(5) Airports.—A bond issued as a part of an issue 95 percent or more of the net proceeds of which are to be used to provide an airport (within the meaning of section 103(b)(4)(D) of the 1954 Code) shall be treated as an exempt facility bond (for facilities described in section 142(a)(1) of the 1986 Code) for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if the facility is described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if such facility is a hotel at an airport facility serving a city described in section 631(a)(3) of the Tax Reform Act of 1984 (relating to certain bonds for a convention center and resource recovery project). The aggregate face amount of bonds to which this subparagraph applies shall not exceed $40,000,000.

(B) A facility is described in this subparagraph if such facility is the primary airport for a city described in paragraph (3)(C). The aggregate face amount of bonds to which this subparagraph applies shall not exceed $500,000,000. Section 148(d)(2) of the 1986 Code shall not apply to any issue to which this subparagraph applies. A facility shall be described in this subparagraph if it would be so described if "90 percent" were substituted for "95 percent" in the material preceding subparagraph (A).

(C) A facility is described in this subparagraph if such facility is a hotel at Logan airport and such hotel is located on land leased from a State authority under a lease contemplating development of such hotel dated May 1, 1983, or under an amendment, renewal, or extension of such a lease. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $40,000,000.

(D) A facility is described in this subparagraph if such facility is the airport for the County of Sacramento, California. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $150,000,000.

(6) REDEVELOPMENT PROJECTS.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to finance redevelopment activities as part of a project within a specific designated area shall be treated as a qualified redevelopment bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such project is described in any of the following subparagraphs:

(A) A project is described in this subparagraph if it was the subject of a city ordinance numbered 82–115 and adopted on December 2, 1982, or numbered 9590 and adopted on April 6, 1983. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $9,000,000.

(B) A project is described in this subparagraph if it is a redevelopment project for an area in a city described in paragraph (3)(C) which was designated as commercially blighted on November 14, 1975, by the city council and the redevelopment plan for which will be approved by the city council before January 31, 1987. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $20,000,000.

(C) A project is described in this subparagraph if it is a redevelopment project for an area in a city described in paragraph (3)(C) which was designated as commercially blighted on March 28, 1979, by the city council and the redevelopment plan for which was approved by the city council on June 20, 1984. The aggregate face amount of bonds to

which this subparagraph applies shall not exceed $100,000,000.

(D) A project is described in this subparagraph if it is any one of three redevelopment projects in areas in a city described in paragraph (3)(C) designated as blighted by a city council before January 31, 1987 and with respect to which the redevelopment plan is approved by the city council before January 31, 1987. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $20,000,000.

(E) A project is described in this subparagraph if such project is for public improvements (including street reconstruction and improvement of underground utilities) for Great Falls, Montana, with respect to which engineering estimates are due on October 1, 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $3,000,000.

(F) A project is described in this subparagraph if—

(i) such project is located in an area designated as blighted by the governing body of the city on February 15, 1983 (Resolution No. 4573), and

(ii) such project is developed pursuant to a redevelopment plan adopted by the governing body of the city on March 1, 1983 (Ordinance No. 15073).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $5,000,000.

(G) A project is described in this subparagraph if—

(i) such project is located in an area designated by the governing body of the city in 1983,

(ii) such project is described in a letter dated August 8, 1985, from the developer's legal counsel to the development agency of the city, and

(iii) such project consists primarily of retail facilities to be built by the developer named in a resolution of the governing body of the city on August 30, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(H) A project is described in this subparagraph if—

(i) such project is a project for research and development facilities to be used primarily to benefit a State university and related hospital, with respect to which an urban renewal district was created by the city council effective October 11, 1985, and

(ii) such project was announced by the university and the city in March 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $40,000,000.

(I) A project is described in this subparagraph if such project is a downtown redevelopment project with respect to which—

(i) an urban development action grant was made, but only if such grant was preliminarily approved on November 3, 1983, and received final approval before June 1, 1984, and

(ii) the issuer of bonds with respect to such facility adopted a resolution indicating the issuer's intent to adopt such redevelopment project on October 6, 1981, and the issuer adopted an ordinance adopting such redevelopment project on December 13, 1983.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $10,000,000.

(J) A project is described in this subparagraph if—

(i) with respect to such project the city council adopted on December 16, 1985, an ordinance directing the urban renewal authority to study blight and produce an urban renewal plan,

(ii) the blight survey was accepted and approved by the urban renewal authority on March 20, 1986, and

(iii) the city planning board approved the urban renewal plan on May 7, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(K) A project is described in this subparagraph if—

(i) the city redevelopment agency approved resolutions authorizing issuance of land acquisition and public improvements bonds with respect to such project on August 8, 1978,

(ii) such resolutions were later amended in June 1979, and

(iii) the State Supreme Court upheld a lower court decree validating the bonds on December 11, 1980.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $380,000,000.

(L) A project is described in this subparagraph if it is a mixed use redevelopment project either—

(i) in an area (known as the Near South Development Area) with respect to which the planning department of a city described in paragraph 3(C) promulgated a draft development plan dated March 1986, and which was the subject of public hearings held by a subcommittee of the plan commission of such city on May 28, 1986, and June 10, 1986, or

(ii) in an area located within the boundaries of any one or more census tracts which are directly adjacent to a river whose course runs through such city.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(M) A project is described in this subparagraph if it is a redevelopment project for an area in a city described in paragraph 3(C) and such area—

(i) was the subject of a report released in May 1986, prepared by the National Park Service, and

(ii) was the subject of a report released January 1986, prepared by a task force appointed by the Mayor of such city.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(N) A project is described in this subparagraph if it is a city-university redevelopment project approved by a city ordinance No. 152–0–84 and the development plan for which was adopted on January 28, 1985. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $23,760,000.

(O) A project is described in this subparagraph if—

(i) an inducement resolution was passed on March 9, 1984, for issuance of bonds with respect to such project,

(ii) such resolution was extended by resolutions passed on August 14, 1984, April 2, 1985, August 13, 1985, and July 8, 1986,

(iii) an urban development action grant was preliminarily approved for part or all of such project on July 3, 1986, and

(iv) the project is located in a district designated as the Peabody-Gayoso District.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $140,000,000.

(P) A project is described in this subparagraph if the project is a 1-block area of a central business district containing a YMCA building with respect to which—

(i) the city council adopted a resolution expressing an intent to issue bonds for the project on September 27, 1985,

(ii) the city council approved project guidelines for the project on December 20, 1985, and

(iii) the city council by resolution (adopted on July 30, 1986) directed completion of a development agreement.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $26,000,000.

(Q) A project is described in this subparagraph if the project is a 2-block area of a central business district designated as blocks E and F with respect to which—

(i) the city council adopted guidelines and criteria and authorized a request for development proposals on July 22, 1985,

(ii) the city council adopted a resolution expressing an intent to issue bonds for the project on September 27, 1985, and

(iii) the city issued requests for development proposals on March 28, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $47,000,000.

(R) A project is described in this subparagraph if the project is an urban renewal project covering approximately 5.9 acres of land in the Shaw area of the northwest section of the District of Columbia and the 1st portion of such project was the subject of a District of Columbia public hearing on June 2, 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $10,000,000.

(S) A project is described in this subparagraph if such project is a hotel, commercial, and residential project on the east bank of the Grand River in Grand Rapids, Michigan, with respect to which a developer was selected by the city in June 1985 and a planning agreement was executed in August 1985. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $39,000,000.

(T) A project is described in this subparagraph if such project is the Wurzburg Block Redevelopment Project in Grand Rapids, Michigan. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(U) A project is described in this subparagraph if such project is consistent with an urban renewal plan adopted or ordered prepared before August 28, 1986, by the city council of the most populous city in a state which entered the Union on February 14, 1859. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $83,000,000.

(V) A project is described in this subparagraph if such project is consistent with an urban renewal plan which was adopted (or ordered prepared) before August 13, 1985, by an appropriate jurisdiction of a state which entered the Union on February 14, 1859. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $135,000,000 and the limitation on the period during which bonds under this section may be issued shall not apply to such bonds.

(W) A project is described in this paragraph if such project—

(i) is located on lands submerged under the waters of a Great Lake or on adjacent lands which formerly were submerged under the waters of such lake;

(ii) project lands were improved with a stadium which was demolished prior to December 31, 1983, and

(iii) legislation for the project was included in a biennium budget for such the State in which it is to be located prior to December 31, 1983.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $105,000,000.

(X) Any designated area with respect to which a project is described in any subparagraph of this paragraph shall be taken into account in applying section 144(c)(4)(C) of the 1986 Code in determining whether other areas (not so described) may be designated.

(7) Convention centers.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide any convention or trade show facility (within the meaning of section 103(b)(4)(C) of the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facility is described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if—

(i) a feasibility consultant and a design consultant were hired on April 3, 1985, with respect to such facility, and

(ii) a draft feasibility report with respect to such facility was presented on November 3, 1985, to the Mayor of the city in which such facility is to be located.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $190,000,000. For purposes of this subparagraph, not more than $20,000,000 of bonds issued to advance refund existing convention facility bonds sold on May 12, 1978, shall be treated as bonds described in this subparagraph.

(B) A facility is described in this subparagraph if—

(i) an application for a State loan for such facility was approved by the city council on March 4, 1985, and

(ii) the city council of the city in which such facility is to be located approved on March 25, 1985, an application for an urban development action grant.

The aggregate face amount of bonds which this subparagraph applies shall not exceed $10,000,000.

(C) A facility is described in this subparagraph if—

(i) on November 1, 1983, a convention development tax took effect and was dedicated to financing such facility,

(ii) the State supreme court of the State in which the facility is to be located validated such tax on February 8, 1985, and

(iii) an agreement was entered into on November 14, 1985, between the city and county in which such facility is to be located on the terms of the bonds to be issued with respect to such facility.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $66,000,000.

(D) A facility is described in this subparagraph if such facility was initially approved in 1983 and is for San Jose, California. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $100,000,000.

(E) A facility is described in this subparagraph if—

(i) such facility is meeting rooms for a convention center, and

(ii) resolutions and ordinances were adopted with respect to such meeting rooms on January 17, 1983, July 11, 1983, December 17, 1984, and September 23, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(F) A facility is described in this subparagraph if it is an international trade center which is part of the 125th Street redevelopment project in New York, New York. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $165,000,000.

(G) A facility is described in this subparagraph if—

(i) such facility is located in a city which was the subject of a convention center market analysis or study

dated March 1983, and prepared by a nationally recognized accounting firm,

(ii) such facility's location was approved by a task force created jointly, in December 1985, by the Governor or the State within which such facility will be located and the mayor of the capital city of such State, and

(iii) the size of such facility is not more than 200,000 square feet.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $70,000,000.

(H) A facility is described in this subparagraph if an analysis of operations and recommendations of utilization of such facility was prepared by a certified public accounting firm pursuant to an engagement authorized on March 6, 1984, and presented on June 11, 1984, to officials of the city in which such facility is located. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(I) A facility is described in this subparagraph if—

(i) voters approved a bond issue to finance the acquisition of the site for such facility on May 4, 1985,

(ii) title of the property was transferred from the Illinois Center Gulf Railroad to the city on September 30, 1985, and

(iii) a United States judge rendered a decision regarding the fair market value of the site of such facility on December 30, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $131,000,000.

(J) A facility is described in this subparagraph if—

(i) such facility is to be used for an annual civic festival, and

(ii) a referendum was held in the spring of 1985 in which voters permitted the city council to lease 130 acres of dedicated parkland to such festival, and

(iii) the city council passed an inducement resolution on June 19, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $5,000,000.

(K) A facility is described in this subparagraph if—

(i) voters approved a bond issued to finance a portion of the cost of such facility on December 1, 1984, and

(ii) such facility was the subject of a market study and financial projections dated March 21, 1986, prepared by a nationally recognized accounting firm.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $5,000,000.

(L) A facility is described in this subparagraph if—

(i) on July 12, 1984, the city council passed a resolution increasing the local hotel and motel tax to 7 percent to assist in paying for such facility,

(ii) on October 25, 1984, the city council selected a consulting firm for such facility, and

(iii) with respect to such facility, the city council appropriated funds for additional work on February 7, 1985, October 3, 1985, and June 26, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $120,000,000.

(M) A facility is described in this subparagraph if—

(i) a board of county commissioners, in an action dated January 21, 1986, supported an application for official approval of the facility, and

(ii) the State economic development commission adopted a resolution dated February 25, 1986, determining the facility to be an eligible facility pursuant to State law and the rules adopted by the commission.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $7,500,000.

(8) SPORTS OR CONVENTION FACILITIES.—A bond issued as a part of an issue 95 percent or more of the net proceeds of which are to be used to provide either a sports facility (within the meaning of section 103(b)(4)(B) of the 1954 Code) or a convention facility (within the meaning of section 103(b)(4)(C) of the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facility is described in any of the following subparagraphs:

(A) A combined convention and arena facility, or any part thereof (whether on the same or different sites), is described in this subparagraph if—

(i) bonds for the expansion, acquisition, or construction of such combined facility are payable from a tax and are issued under a plan initially approved by the voters of the taxing authority on April 25, 1978, and

(ii) such bonds were authorized for expanding a convention center, for acquiring an arena site, and for building an arena or any of the foregoing pursuant to a resolution adopted by the governing body of the bond issuer on March 17, 1986, and superseded by a resolution adopted by such governing body on May 27, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $160,000,000.

(B) A sports or convention facility is described in this subparagraph if—

(i) on March 4, 1986, county commissioners held public hearings on creation of a county convention facilities authority, and

(ii) on March 7, 1986, the county commissioners voted to create a county convention facilities authority and to submit to county voters a ½ cent sales and use tax to finance such facility.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $150,000,000.

(C) A sports or convention facility is described in this subparagraph if—

(i) a feasibility consultant and a design consultant were hired prior to October 1980 with respect to such facility,

(ii) a feasibility report dated October 1980 with respect to such facility was presented to a city or county in which such facility is to be located, and

(iii) on September 7, 1982, a joint city/county resolution appointed a committee which was charged with the task of independently reviewing the studies and present need for the facility.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(D) A sports or convention facility is described in this subparagraph if—

(i) such facility is a multipurpose coliseum facility for which, before January 1, 1985, a city, an auditorium district created by the State legislature within which such facility will be located, and a limited partnership executed an enforceable contract,

(ii) significant governmental action regarding such facility was taken before May 23, 1983, and

(iii) inducement resolutions were passed for issuance of bonds with respect to such facility on May 26, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $25,000,000.

(9) PARKING FACILITIES.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide a parking facility (within the meaning of section 103(b)(4)(D) of the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facility is described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if—

(i) there was an inducement resolution on March 9, 1984, for the issuance of bonds with respect to such facility, and

(ii) such resolution was extended by resolutions passed on August 14, 1984, April 2, 1985, August 13, 1985, and July 8, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $30,000,000.

(B) A facility is described in this subparagraph if—

(i) such facility is for a university medical school,

(ii) the last parcel of land necessary for such facility was purchased on February 4, 1985, and

(iii) the amount of bonds to be issued with respect to such facility was increased by the State legislature of the State in which the facility is to be located as part of its 1983-1984 general appropriations act.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $9,000,000.

(C) A facility is described in this subparagraph if—

(i) the development agreement with respect to the project of which such facility is a part was entered into during May 1984, and

(ii) an inducement resolution was passed on October 9, 1985, for the issuance of bonds with respect to the facility.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $35,000,000.

(D) A facility is described in this subparagraph if the city council approved a resolution of intent to issue tax-exempt bonds (Resolution 34083) for such facility on April 30, 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $8,000,000. Solely for purposes of this subparagraph, a heliport constructed as part of such facility shall be deemed to be functionally related and subordinate to such facility.

(E) A facility is described in this subparagraph if—

(i) resolutions were adopted by a public joint powers authority relating to such facility on March 5, 1985, May 1, 1985, October 2, 1985, December 4, 1985, and February 5, 1986; and

(ii) such facility is to be located at an exposition park which includes a coliseum and sports arena.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $150,000,000.

(F) A facility is described in this subparagraph if—

(i) it is to be constructed as part of an overall development that is the subject of a development agreement dated October 1, 1983, between a developer and an organization described in section 501(c)(3) of the 1986 Code, and

(ii) an environmental notification form with respect to the overall development was filed with a State environmental agency on February 28, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(G) A facility is described in this subparagraph if—

(i) an inducement resolution was passed by the city redevelopment agency on December 3, 1984, and a resolution to carryforward the private activity bond limit was passed by such agency on December 21, 1984, with respect to such facility, and

(ii) the owner participation agreement with respect to such facility was entered into on July 30, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $18,000,000.

(H) A facility is described in this subparagraph if—

(i) an application (dated August 28, 1986) for financial assistance was submitted to the county industrial development agency with respect to such facility, and

(ii) the inducement resolution for such facility was passed by the industrial development agency on September 10, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $8,000,000.

(I) A facility is described in this subparagraph if—

(i) it is located in a city the parking needs of which were comprehensively described in a "Downtown Parking Plan" dated January 1983, and approved by the city's City Plan Commission on June 1, 1983, and

(ii) obligations with respect to the construction of which are issued on behalf of a State or local governmental unit by a corporation empowered to issue the same which was created by the legislative body of a State by an Act introduced on May 21, 1985, and thereafter passed, which Act became effective without the governor's signature on June 26, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $50,000,000.

(J) A facility is described in this subparagraph if—

(i) such facility is located in a city which was the subject of a convention center market analysis or study dated March 1983 and prepared by a nationally recognized accounting firm,

(ii) such facility is intended for use by, among others, persons attending a convention center located within the same town or city, and

(iii) such facility's location was approved by a task force created jointly, in December 1985, by the governor of the State within which such facility will be located and the mayor of the capital city of such State.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $30,000,000.

(K) A facility is described in this subparagraph if—

(i) scale and components for the facility were determined by a city downtown plan adopted October 31, 1984 (resolution number 3882), and

(ii) the site area for the facility is approximately 51,200 square feet.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $5,000,000.

(L) A facility is described in this subparagraph if—

(i) the property for such facility was offered for development by a city renewal agency on March 19, 1986 (resolution number 920), and

(ii) the site area for the facility is approximately 25,600 square feet.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $5,000,000.

(M) A facility is described in this subparagraph if such facility was approved by official action of the city council on July 26, 1984 (resolution number 33718), and is for the Moyer Theatre. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $8,000,000.

(N) A facility is described in this subparagraph if it is part of a renovation project involving the Outlet Company building in Providence, Rhode Island. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $6,000,000.

(10) CERTAIN ADVANCE REFUNDINGS.—

(A) Section 149(d)(3) of the 1986 Code shall not apply to a bond issued by a State admitted to the Union on November 16, 1907, for the advance refunding of not more than $186,000,000 State turnpike obligations.

(B) A refunding of the Charleston, West Virginia Town Center Garage Bonds shall not be treated for purposes of part IV of subchapter A of chapter 1 of the 1986 Code as an advance refunding if it would not be so treated if "100" were substituted for "90" in section 149(d)(5) of such Code.

(11) PRINCIPAL USER PROVISIONS.—

(A) In the case of a bond issued as part of an issue the proceeds of which are to be used to provide a facility described in subparagraph (B) or (C), the determination of whether such bond is an exempt facility bond shall be made by substituting "90 percent" for "95 percent" and section 142(a) of the 1986 Code.

(B) A facility is described in this subparagraph if—

(i) it is a waste-to-energy project for which a contract for the sale of electricity was executed in September 1984, and

(ii) the design, construction, and operation contract for such project was signed in March 1985 and the order to begin construction was issued on March 31, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $29,100,000.

(C) A facility is described in this subparagraph if it is a solid waste disposal facility for Charleston, South Carolina, and a State political subdivision took formal action on April 1, 1980, to commit development funds for such facility.

(12) QUALIFIED SCHOLARSHIP FUNDING BONDS.—Subsections (d)(3) and (f) of section 148 of the 1986 Code shall not apply to any bond or series of bonds the proceeds of which are used exclusively to refund qualified scholarship funding bonds (as defined in section 150 of the 1986 Code) issued before January 1, 1986, if—

(A) the amount of the refunding bonds does not exceed the aggregate face amount of the refunded bonds,

(B) the maturity date of such refunding bond is not later than later of—

(i) the maturity date of the bond to be refunded, or

(ii) the date which is 15 years after the date on which the refunded bond was issued (or, in the case of a series of refundings, the date on which the original bond was issued),

(C) the bonds to be refunded were issued by the California Student Loan Finance Corporation, and

(D) the face amount of the refunding bonds does not exceed $175,000,000.

(13) RESIDENTIAL RENTAL PROPERTY PROJECTS.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide a project for residential

rental property which satisfies the requirements of section 103(b)(4)(A) of the 1954 Code shall be treated as an exempt facility bond (for projects described in section 142(a)(7) of the 1986 Code) for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if the project is described in any of the following subparagraphs:

(A) A residential rental property project is described in this subparagraph if—

(i) a public building development corporation was formed on June 6, 1984, with respect to such project,

(ii) a partnership of which the corporation is a general partner was formed on June 8, 1984, and

(iii) the partnership entered into a preliminary agreement with the State public facilities authority effective as of May 4, 1984, with respect to the issuance of the bonds for such project.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $6,200,000.

(B) A residential rental property project is described in this subparagraph if—

(i) the Board of Commissioners of the city housing authority officially selected such project's developer on December 19, 1985,

(ii) the Board of the City Redevelopment Commission agreed on February 13, 1986, to conduct a public hearing with respect to the project on March 6, 1986,

(iii) an official action resolution for such project was adopted on March 6, 1986, and

(iv) an allocation of a portion of the State ceiling was made with respect to such project on July 29, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $10,000,000.

(C) A residential rental property project is described in this subparagraph if—

(i) the issuance of $1,289,882 of bonds for such project was approved by a State agency on September 11, 1985, and

(ii) the authority to issue such bonds was scheduled to expire (under the terms of the State approval) on September 9, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $1,300,000.

(D) A residential rental property project is described in this subparagraph if—

(i) the issuance of $7,020,000 of bonds for such project was approved by a State agency on October 10, 1985, and

(ii) the authority to issue such bonds was scheduled to expire (under the terms of the State approval) on October 9, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $7,020,000.

(E) A residential rental property project is described in this subparagraph if—

(i) it is to be located in a city urban renewal project area which was established pursuant to an urban renewal plan adopted by the city council on May 17, 1960,

(ii) the urban renewal plan was revised in 1972 to permit multifamily dwellings in areas of the urban renewal project designated as a central business district,

(iii) an inducement resolution was adopted for such project on December 14, 1984, and

(iv) the city council approved on November 6, 1985, an agreement which provides for conveyance to the city of fee title to such project site.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(F) A residential rental property project is described in this subparagraph if—

(i) such project is to be located in a city urban renewal project area which was established pursuant to an urban renewal plan adopted by the city council on May 17, 1960,

(ii) the urban renewal plan was revised in 1972 to permit multifamily dwellings in areas of the urban renewal project designated as a central business district,

(iii) the amended urban renewal plan adopted by the city council on May 19, 1972, also provides for the conversion of any public area site in Block J of the urban renewal project area for the development of residential facilities, and

(iv) acquisition of all of the parcels comprising the Block J project site was completed by the city on December 28, 1984.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $60,000,000.

(G) A residential rental property project is described in this subparagraph if—

(i) such project is to be located on a city-owned site which is to become available for residential development upon the relocation of a bus maintenance facility,

(ii) preliminary design studies for such project site were completed in December 1985, and

(iii) such project is located in the same State as the projects described in subparagraphs (E) and (F).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $100,000,000.

(H) A residential rental property project is described in this subparagraph if—

(i) at least 20 percent of the residential units in such project are to be utilized to fulfill the requirements of a unilateral agreement date July 21, 1983, relating to the provision of low- and moderate-income housing,

(ii) the unilateral agreement was incorporated into ordinance numbers 83-49 and 83-50, adopted by the city council and approved by the mayor on August 24, 1983, and

(iii) an inducement resolution was adopted for such project on September 25, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $8,000,000.

(I) A residential rental property project is described in this subparagraph if—

(i) a letter of understanding was entered into on December 11, 1985, between the city and county housing and community development office and the project developer regarding the conveyance of land for such project, and

(ii) such project is located in the same State as the projects described in subparagraphs (E), (F), (G), and (H).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed an amount which, together with the amounts allowed under subparagraphs (E), (F), (G), and (H), does not exceed $250,000,000.

(J) A residential rental property project is described in this subparagraph if it is a multifamily residential development located in Arrowhead Springs, within the county of San Bernardino, California, and a portion of the site of which currently is owned by the Campus Crusade for Christ. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $350,000,000.

(K) A residential rental property project is described in this subparagraph if—

(i) it is a new residential development with approximately 309 dwelling units located in census tract No. 3202, and

(ii) there was an inducement ordinance for such project adopted by a city council on November 20, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $32,000,000.

(L) A residential rental property project is described in this subparagraph if—

(i) it is a new residential development with approximately 70 dwelling units located in census tract No. 3901, and

(ii) there was an inducement ordinance for such project adopted by a city council on August 14, 1984.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $4,000,000.

(M) A residential rental property project is described in this subparagraph if—

(i) it is a new residential development with approximately 98 dwelling units located in census tract No. 4701, and

(ii) there was an inducement ordinance for such project adopted by a city council on August 14, 1984.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $7,000,000.

(N) A project or projects are described in this subparagraph if they are part of the Willow Road residential im-

provement plan in Menlo Park, California. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $9,000,000.

(O) A residential rental property project is described in this subparagraph if—

(i) an inducement resolution for such project was approved on July 18, 1985, by the city council,

(ii) such project was approved by such council on August 11, 1986, and

(iii) such project consists of approximately 22 duplexes to be used for housing qualified low and moderate income tenants.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $1,500,000.

(P) A residential rental property project is described in this subparagraph if—

(i) an inducement resolution for such project was approved on April 22, 1986, by the city council,

(ii) such project was approved by such council on August 11, 1986, and

(iii) such project consists of a unit apartment complex (having approximately 60 units) to be used for housing qualified low and moderate income tenants.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $1,625,000.

(Q) A residential rental property project is described in this subparagraph if—

(i) a State housing authority granted a notice of official action for the project on May 24, 1985, and

(ii) a binding agreement was executed for such project with the State housing finance authority on May 14, 1986, and such agreement was accepted by the State housing authority on June 5, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $7,800,000.

(R) A residential rental property project is described in this subparagraph if such project is either of 2 projects (located in St. Louis, Missouri) which received commitments to provide construction and permanent financing through the issuance of bonds in principal amounts of up to $242,130 and $654,045, on July 16, 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $1,000,000.

(S) A residential rental property project is described in this subparagraph if—

(i) a local housing authority approved an inducement resolution for such project on January 28, 1985, and

(ii) a suit relating to such project was dismissed without right of further appeal on April 4, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $13,200,000.

(T) A residential rental property project is described in this subparagraph if—

(i) such project is the renovation of a hotel for residents for senior citizens,

(ii) an inducement resolution for such project was adopted on November 20, 1985, by the State Development Finance Authority, and

(iii) such project is to be located in the metropolitan area of the city described in paragraph (3)(C).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $9,500,000.

(U) A residential rental property project is described in this subparagraph if—

(i) such project is the renovation of apartment housing,

(ii) an inducement resolution for such project was adopted on December 20, 1985, by the State Housing Development Authority, and

(iii) such project is to be located in the metropolitan area of the city described in paragraph (3)(C).

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $12,000,000.

(V) A residential rental project is described in this subparagraph if it is a renovation and construction project for low-income housing in central Louisville, Kentucky, and local board approval for such project was granted April 22, 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $500,000.

(W) A residential rental project is described in this subparagraph if—

(i) such project is 1 of 6 residential rental projects having in the aggregate approximately 1,010 units,

(ii) inducement resolutions for such projects were adopted by the county residential finance authority on November 21, 1985, and

(iii) a public hearing of the county residential finance authority was held by such authority on December 19, 1985, regarding such projects to be constructed by an in-commonwealth developer.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $62,000,000.

(X) A residential rental project is described in this subparagraph if—

(i) an inducement resolution with respect to such project was adopted by the State housing development authority on January 25, 1985, and

(ii) the issuance of bonds for such project was the subject of a law suit filed on October 25, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $64,000,000. In the case of bonds to which this subparagraph applies, the requirements of sections 148 and 149(d) of the 1986 Code shall not be treated as included in section 103 of the 1954 Code and shall apply to such bonds.

(Y) A project or projects are described in this subparagraph if they are financed with bonds issued by the Tulare

California, County Housing Authority. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $8,000,000.

(Z) A residential rental project is described in this subparagraph if such project is a multifamily mixed-use housing project located in a city described in paragraph (3)(C), the zoning for which was changed to residential-business planned development on November 26, 1985, and with respect to which both the city on December 4, 1985, and the state housing finance agency on December 20, 1985, adopted inducement resolutions. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $90,000,000.

(14) QUALIFIED STUDENT LOANS.—The amendments made by section 1301 shall not apply to any qualified student loan bonds (as defined in section 144 of the 1986 Code) issued by the Volunteer State Student Assistance Corporation. The aggregate face amount of bonds to which this paragraph applies shall not exceed $90,000,000. In the case of bonds to which this paragraph applies, the requirements of sections 148 and 149(d) of the 1986 Code shall be treated as included in section 103 of the 1954 Code and shall apply to such bonds.

(15) ANNUITY CONTRACTS.—The treatment of annuity contracts as investment property under section 148(b)(2) of the 1986 Code shall not apply to any bond described in any of the following subparagraphs:

(A) A bond is described in this subparagraph if such bond is issued by a city located in a noncontiguous State if—

(i) the authority to acquire such a contract was approved on September 24, 1985, by city ordinance A085–176, and

(ii) formal bid requests for such contracts were mailed to insurance companies on September 6, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $57,000,000.

(B) A bond is described in this subparagraph if—

(i) on or before May 12, 1985, the governing board of the city pension fund authorized an agreement with an underwriter for possible execution and delivery of tax-exempt certificates of participation by a nonprofit corporation, and

(ii) the proceeds of the sale of such certificates are to be used to purchase an annuity to fund the unfunded liability of the City of Berkeley, California's Safety Members Pension Fund.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $40,000,000.

(C) A bond is described in this subparagraph if such bond is issued by the South Dakota Building Authority if on September 18, 1985, representatives of such authority and its underwriters met with bond counsel and approved financing the purchase of an annuity contract through the sale and leaseback of State properties. The aggregate face

amount of bonds to which this subparagraph applies shall not exceed $175,000,000.

(D) A bond is described in this subparagraph if—

(i) such bond is issued by Los Angeles County, and

(ii) such country, before September 25, 1985, paid or incurred at least $50,000 of costs related to the issuance of such bonds.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $500,000,000.

(16) Solid waste disposal facility.—The amendments made by section 1301 shall not apply to any solid waste disposal facility if—

(A) construction of such facility was approved by State law I.C. 36-9-31,

(B) there was an inducement resolution on November 19, 1984, for the bonds with respect to such facility, and

(C) a carryforward election of unused 1984 volume cap was made for such project on February 25, 1985.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $120,000,000. In the case of bonds to which this paragraph applies, the requirements of sections 148, 149(d), and 149(g) of the 1986 Code shall be treated as included in section 103 of the 1954 Code and shall apply to such bonds.

(17) Refunding of bond anticipation notes.—There shall not be taken into account under section 146 of the 1986 Code any refunding of bond anticipation notes—

(A) issued in December of 1984 by the Rhode Island Housing and Mortgage Finance Corporation,

(B) which mature in December of 1986,

(C) which is not an advance refunding within the meaning of section 149(d)(5) of the 1986 Code (determined by substituting "180 days" for "90 days" therein), and

(D) the aggregate face amount of the refunding bonds does not exceed $25,500,000.

(18) Certain airports.—The amendments made by section 1301 shall not apply to a bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide any airport (within the meaning of section 103(b)(4)(D) of the 1954 Code) if such airport is a mid-field airport terminal and accompanying facilities at a major air carrier airport which during April 1980 opened a new precision instrument approach runway 10R28L. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $425,000,000.

(19) Mass commuting facilities.—A bond issued as a part of an issue 95 percent or more of the net proceeds of which are to be used to provide a mass commuting facility (within the meaning of section 103(b)(4)(D) of the 1954 Code) shall be treated as an exempt facility bond (for facilities described in section 142(a)(3) of the 1986 Code) for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facility is described in 1 of the following subparagraphs:

(A) A facility is described in this subparagraph if—

(i) such facility provides access to an international airport,

(ii) a corporation was formed in connection with such project in September 1984,

(iii) the Board of Directors of such corporation authorized the hiring of various firms to conduct a feasibility study with respect to such project in April 1985, and

(iv) such feasibility study was completed in November 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $150,000,000.

(B) A facility is described in this subparagraph if—

(i) enabling legislation with respect to such project was approved by the State legislature in 1979,

(ii) a 1-percent local sales tax assessment to be dedicated to the financing of such project was approved by the voters on August 13, 1983, and

(iii) a capital fund with respect to such project was established upon the issuance of $90,000,000 of notes on October 22, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000 and such bonds must be issued before January 1, 1996.

(C) A facility is described in this subparagraph if—

(i) bonds issued therefor are issued by or on behalf of an authority organized in 1979 pursuant to enabling legislation originally enacted by the State legislature in 1973, and

(ii) such facility is part of a system connector described in a resolution adopted by the board of directors of the authority on March 27, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $400,000,000. Notwithstanding the last paragraph of this subsection, this subparagraph shall apply to bonds issued before January 1, 1996.

(D) A facility is described in this subparagraph if—

(i) the facility is a light rail transitway project,

(ii) enabling legislation with respect to the issuing authority was approved by the State legislature in May 1973,

(iii) on October 28, 1985, a board issued a request for consultants to conduct a feasibility study on mass transit corridor analysis in connection with the facility, and

(iv) on May 12, 1986, a board approved a further binding contract for expenditures of approximately $1,494,963, to be expended on a facility study.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $250,000,000. Notwithstanding the last paragraph of this subsection, this subparagraph shall apply to bonds issued before January 1, 1996.

(20) PRIVATE COLLEGES.—Section 148(f) of the 1986 Code shall not apply to any bond which is issued as part of an issue if such bond—

(A) is issued by a political subdivision pursuant to home rule and interlocal cooperation powers conferred by the constitution and laws of a State to provide funds to finance the costs of the purchase and construction of educational facilities for private colleges and universities, and

(B) was the subject of a resolution of official action by such political subdivision (Resolution No. 86–1039) adopted by the governing body of such political subdivision on March 18, 1986.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $100,000,000.

(21) POOLED FINANCING PROGRAMS.—

(A) Section 147(b) of the 1986 Code shall not apply to any hospital pooled financing program with respect to which—

(i) a formal presentation was made to a city hospital facilities authority on January 14, 1986, and

(ii) such authority passed a resolution approving the bond issue in principle on February 5, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $95,000,000.

(B) Subsection (c) and (f) of section 148 of the 1986 Code shall not apply to bonds for which closing occurred on July 16, 1986, and for which a State municipal league served as administrator for use in a State described in section 103A(g)(5)(C)) of the Internal Revenue Code of 1954. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $585,000,000.

(22) DOWNTOWN REDEVELOPMENT PROJECT.—

(A) In the case of a bond described in subparagraph (B), section 141 of the 1986 Code shall be applied without regard to subsection (a)(2), subsection (b)(3), and subsection (b)(5); and paragraphs (1) and (2) of subsection (b) shall be applied by substituting "25 percent" for "10 percent" each place it appears.

(B) A bond is described in this subparagraph if such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide a project to acquire and redevelop a downtown area if—

(i) on August 15, 1985, a downtown redevelopment authority adopted a resolution to issue bonds for such project,

(ii) before September 26, 1985, the city expended (or entered into binding contracts to expend) more than $10,000,000 in connection with such project, and

(iii) the state supreme court issued a ruling regarding the proposed finance structure for such project on December 11, 1985.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $85,000,000 and such bonds must be issued before January 1, 1992.

(23) MASS COMMUTING AND PARKING FACILITIES.—A bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide any mass commuting facility or parking facility (within the meaning of section 103(b)(4)(D) of

the 1954 Code) shall be treated as an exempt facility bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if such facility is provided in connection with the rehabilitation, renovation, or other improvement to an existing railroad station owned on the date of the enactment of this Act by the National Railroad Passenger Corporation in the Northeast Corridor and which was placed in partial service in 1934 and was placed in the National Register of Historic Places in 1978. The aggregate face amount of bonds to which this paragraph applies shall not exceed $30,000,000.

(24) TAX-EXEMPT STATUS OF BONDS OF CERTAIN EDUCATIONAL ORGANIZATIONS.—

(A) IN GENERAL.—For purposes of section 103 and part IV of subchapter B of chapter 1 of the 1986 Code, a qualified educational organization shall be treated as a governmental unit, but only with respect to a trade or business carried on by such organization which is not an unrelated trade or business (determined by applying section 513(a) of such Code to such organization).

(B) QUALIFIED EDUCATIONAL ORGANIZATION.—For purposes of subparagraph (A), the term "qualified educational organization" means a college or university—

(i) which was reincorporated and renewed with perpetual existence as a corporation by specific act of the legislature of the State within which such college or university is located on March 19, 1913, or

(ii) which—

(I) was initially incorporated or created on February 28, 1787, on April 29, 1854, or on May 14, 1888, and

(II) as an instrumentality of the State, serves as a "State-related" university by a specific act of the legislature of the State within which such college or university is located.

(25) TAX-EXEMPT STATUS OF BONDS OF CERTAIN PUBLIC UTILITIES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), a bond shall be treated as a qualified bond for purposes of section 103 of the 1986 Code if such bond is issued after the date of the enactment of this Act with respect to a public utility facility if such facility is—

(i) located at any non-federally owned dam (or on project waters or adjacent lands) located wholly or partially in 3 counties, 2 of which are contiguous to the third, where the rated capacity of the hydroelectric generating facilities at 5 of such dams on October 18, 1979, was more than 650 megawatts each,

(ii) located at a dam (or on the project waters or adjacent lands) at which hydroelectric generating facilities were financed with the proceeds of tax-exempt obligations before December 31, 1968,

(iii) owned and operated by a State, political subdivision of a State, or any agency or instrumentality of any of the foregoing, and

(iv) located at a dam (or on project waters or adjacent lands) where the general public has access for recreational purposes to such dam or to such project waters or adjacent lands.

(B) SPECIAL RULES FOR SUBPARAGRAPH (a).—

(i) BONDS SUBJECT TO CAP.—Section 146 of the 1986 Code shall apply to any bond described in subparagraph (A) which (without regard to subparagraph (A)) is a private activity bond.

(ii) LIMITATION ON AMOUNT OF BONDS TO WHICH SUBPARAGRAPH (a) APPLIES.—The aggregate face amount of bonds to which subparagraph (A) applies shall not exceed $750,000,000, not more than $350,000,000 of which may be issued before January 1, 1992.

(iii) LIMITATION ON PURPOSES.—Subparagraph (A) shall only apply to bonds issued as part of an issue 95 percent or more of the net proceeds of which are used to provide 1 or more of the following:

(I) A fish by-pass facility or fisheries enhancement facility.

(II) A recreational facility or other improvement which is required by Federal licensing terms and conditions or other Federal, State, or local law requirements.

(III) A project of repair, maintenance, renewal, or replacement, and safety improvement.

(IV) Any reconstruction, replacement, or improvement, including any safety improvement, which increases, or allows an increase in, the capacity, efficiency, or productivity of the existing generating equipment.

(26) CONVENTION AND PARKING FACILITIES.—A bond shall not be treated as a private activity bond for purposes of section 103 and part IV of subchapter B of chapter 1 of the 1986 Code if—

(A) such bond is issued to provide a sports or convention facility described in section 103(b)(4) (B) or (C) of the 1954 Code,

(B) such bond is not described in section 103 (b)(2) or (o)(2)(A) of such Code,

(C) legislation by a State legislature in connection with such facility was enacted on July 19, 1985, and was designated Chapter 375 of the Laws of 1985, and

(D) legislation by a State legislature in connection with the appropriation of funds to a State public benefit corporation for loans in connection with the construction of such facility was enacted on April 17, 1985, and was designated Chapter 41 of the Laws of 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $35,000,000.

(27) SMALL ISSUE TERMINATION.—Section 144(a)(12) of the 1986 Code shall not apply to any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide a facility described in any of the following subparagraphs:

(A) A facility is described in this subparagraph if—

(i) the facility is a hotel and office facility located in a State capital,

(ii) the economic development corporation of the city in which the facility is located adopted an initial inducement resolution on October 30, 1985, and

(iii) a feasibility consultant was retained on February 21, 1986, with respect to such facility.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $10,000,000.

(B) A facility is described in this subparagraph if such facility is financed by bonds issued by a State finance authority which was created in April 1985 by Act 1062 of the State General Assembly, and the Bond Guarantee Act (Act 505 of 1985) allowed such authority to pledge the interest from investment of the State's general fund as a guarantee for bonds issued by such authority. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $75,000,000.

(C) A facility is described in this subparagraph if such facility is a downtown mall and parking project for Holland, Michigan, with respect to which an initial agreement was formulated with the city in May 1985 and a formal memorandum of understanding was executed on July 2, 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $18,200,000.

(D) A facility is described in this subparagraph if such facility is a downtown mall and parking ramp project for Traverse City, Michigan, with respect to which a final development agreement was signed in June 1986. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $21,500,000.

(E) A facility is described in this subparagraph if such facility is the rehabilitation of the Heritage Hotel in Marquette, Michigan. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $5,000,000.

(F) A facility is described in this subparagraph if it is the Lakeland Center Hotel in Lakeland, Florida. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $10,000,000.

(G) A facility is described in this subparagraph if it is the Marble Arcade office building renovation project in Lakeland, Florida. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $5,900,000.

(H) A facility is described in this subparagraph if it is a medical office building in Bradenton, Florida, with respect to which—

(i) a memorandum of agreement was entered into on October 17, 1985, and

(ii) the city council held a public hearing and approved issuance of the bonds on November 14, 1985.

The aggregate face amount of obligations to which this subparagraph applies shall not exceed $8,500,000.

(I) A facility is described in this subparagraph if it consists of the rehabilitation of the Andover Town Hall in Andover, Massachusetts. The provisions of section 149(b) of the 1986 Code (relating to federally guaranteed obligations) shall not apply to obligations to finance such project solely as a result of the occupation of a portion of such building by a United States Post Office.

(J) A facility is described in this subparagraph if it is the Central Bank Building renovation project in Grand Rapids, Michigan. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $1,000,000.

(28) CERTAIN PRIVATE LOANS NOT TAKEN INTO ACCOUNT.—For purposes of determining whether any bond is a private activity bond, an amount of loans (but not in excess of $75,000,000) provided from the proceeds of 1 or more issues shall not be taken into account if such loans are provided in furtherance of—

(A) a city Emergency Conservation Plan as set forth in an ordinance adopted by the city council of such city on February 17, 1983, or

(B) a resolution adopted by the city council of such city on March 10, 1983, committing such city to a goal of reducing the peak load of such city's electric generation and distribution system by 553 megawatts in 15 years.

(29) CERTAIN PRIVATE BUSINESS USE NOT TAKEN INTO ACCOUNT.—

(A) The nonqualified amount of the proceeds of an issue shall not be taken into account under section 141(b)(5) of the 1986 Code or in determining whether a bond described in subparagraph (B) (which is part of such issue) is a private activity bond for purposes of section 103 and part IV of subchapter B of chapter 1 of the 1986 Code.

(B) A bond is described in this subparagraph if—

(i) such bond is issued before January 1, 1993, by a State admitted to the Union on June 14, 1776, and

(ii) such bond is issued pursuant to a resolution of the State Bond Commission adopted before September 26, 1985.

(C) The nonqualified amount to which this paragraph applies shall not exceed $150,000,000.

(D) For purposes of this paragraph, the term "nonqualified amount" has the meaning given such term by section 141(b)(8) of the 1986 Code, except that such term shall include the amount of the net proceeds of an issue which is to be used (directly or indirectly) to make or finance loans (other than loans described in section 141(c)(2) of the 1986 Code) to persons other than governmental units.

(30) VOLUME CAP NOT TO APPLY TO CERTAIN FACILITIES.—For purposes of section 146 of the 1986 Code, any exempt facility bond for the following facility shall not be taken into account: The facility is a facility for the furnishing of water which was authorized under Public Law 90-537 of the United States if—

(A) construction of such facility began on May 6, 1973, and

(B) forward funding will be provided for the remainder of the project pursuant to a negotiated agreement between State and local water users and the Secretary of the Interior signed April 15, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $391,000,000.

(31) CERTAIN HYDROELECTRIC GENERATING PROPERTY.—A bond shall be treated as described in paragraph (2) of section 1316(f) of this Act if—

(A) such bond would be so described but for the substitution specified in such paragraph,

(B) on January 7, 1983, an application for a preliminary permit was filed for the project for which such bond is issued and received docket no. 6986, and

(C) on September 20, 1983, the Federal Energy Regulatory Commission issued an order granting the preliminary permit for the project.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $12,000,000.

(32) VOLUME CAP.—The State ceiling applicable under section 146 of the 1986 Code for calendar year 1987 for the State which ratified the United States Constitution on May 29, 1790, shall be $150,000,000 higher than the State ceiling otherwise applicable under such section for such year.

(33) APPLICATION OF $150,000,000 LIMITATION FOR CERTAIN QUALIFIED 501(C)(3) BONDS.—Proceeds of an issue described in any of the following subparagraphs shall not be taken into account under section 145(b) of the 1986 Code.

(A) Proceeds of an issue are described in this subparagraph if—

(i) such proceeds are used to provide medical school facilities or medical research and clinical facilities for a university medical center,

(ii) such proceeds are of—

(I) a $21,550,000 issue on August 1, 1980,

(II) a $84,400,000 issue on September 1, 1984, and

(III) a $48,500,000 issue (Series 1985 A and 1985 B), and

(iii) the issuer of all such issues is the same.

(B) Proceeds of an issue are described in this subparagraph if such proceeds are for use by Yale University and—

(i) the bonds are issued after August 8, 1986, and before August 7, 1988, by the State of Connecticut Health and Educational Facilities Authority, or

(ii) the bonds are the 1st or 2nd refundings (including advance refundings) of the bonds described in clause (i) or of original bonds issued before August 7, 1986, by such Authority.

(C) Proceeds of an issue are described in this subparagraph if—

(i) such issue is issued on behalf of a university established by Charter granted by King George II of Eng-

land on October 31, 1754, to accomplish a refunding (including an advance refunding) of bonds issued to finance 1 or more projects, and

(ii) the application or other request for the issuance of the issue to the appropriate State issuer was made by or on behalf of such university before February 26, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $250,000,000.

(D) Proceeds of an issue are described in this subparagraph if—

(i) such proceeds are to be used for finance construction of a new student recreation center,

(ii) a contract for the development phase of the project was signed by the university on May 21, 1986, with a private company for 5 percent of the costs of the project, and

(iii) a committee of the university board of administrators approved the major program elements for the center on August 11, 1986.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $25,000,000.

(E) Proceeds of an issue are described in this subparagraph if—

(i) such proceeds are to be used in the construction of new life sciences facilities for a university for medical research and education,

(ii) the president of the university authorized a faculty/administration planning committee for such facilities on September 17, 1982,

(iii) the trustees of such university authorized site and architect selection on October 30, 1984, and

(iv) the university negotiated a $2,600,000 contract with the architect on August 9, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $47,500,000.

(F) Proceeds of an issue are described in this subparagraph if such proceeds are to be used to renovate undergraduate chemistry and engineering laboratories, and to rehabilitate other basic science facilities, for an institution of higher education in Philadelphia, Pennsylvania, chartered by legislative Acts of the Commonwealth of Pennsylvania, including an Act dated September 30, 1791. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $6,500,000.

(G) Proceeds of an issue are described in this subparagraph if such proceeds are of bonds which are the first advance refunding of bonds issued during 1985 for the development of a computer network, and construction and renovation or rehabilitation of other facilities, for an institution of higher education described in subparagraph (H). The aggregate face amount of bonds to which this subparagraph applies shall not exceed $80,000,000.

(H) Proceeds of an issue are described in this subparagraph if—

(i) the issue is issued on behalf of a university founded in 1789, and

(ii) the request to issue bonds for items to be determined by the issuer was transmitted to Congress on November 7, 1985.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $200,000,000.

(I) Proceeds of an issue are described in this subparagraph if the issue is issued on behalf of a university established on August 6, 1872, for a project approved by the trustees thereof on November 11, 1985. The aggregate face amount of bonds to which this subparagraph applies shall not exceed $100,000,000.

(J) Proceeds of an issue are described in this subparagraph if—

(i) the issue is issued on behalf of a university for which the founding grant was signed on November 11, 1885, and

(ii) such bond is issued for the purpose of providing a Near West Campus Redevelopment Project and a Student Housing Project.

The aggregate face amount of bonds to which this subparagraph applies shall not exceed $105,000,000.

(J) Proceeds of an issue are described in this subparagraph if—

(i) they are the proceeds of advance refunding obligations issued on behalf of a university established on April 21, 1831, and

(ii) the application or other request for the issuance of such obligations was made to the appropriate State issuer before July 12, 1986.

The aggregate face amount of obligations to which this subparagraph applies shall not exceed $175,000,000.

(K) Proceeds of an issue are described in this subparagraph if—

(i) the issue is for the purpose of financing or refinancing costs associated with university facilities including 900 units of housing for students, faculty, and staff in up to two buildings and an office building containing up to 2,000 square feet of space, and

(ii) a bond act authorizing the issuance of such bonds for such project was adopted on July 8, 1986, and such act under Federal law was required to be transmitted to Congress.

The aggregate face amount of obligations to which this subparagraph applies shall not exceed $150,000,000.

(L) Proceeds of an issue are described in this subparagraph if such issue is for Cornell University in an aggregate face amount of not more than $150,000,000.

(M) Proceeds of an issue are described in this subparagraph if—

(i) such issue would not (if issued before August 16, 1986) be an industrial development bond (as defined in section 103(b)(2) of the 1954 Code), and

(ii) such bonds were approved by city voters on January 19, 1985, for an art museum and 2 theaters.

The aggregate face amount of obligations to which this subparagraph applies shall not exceed $2,300,000.

(N) Proceeds of an issue are described in this subparagraph if—

(i) such issue is issued by a State dormitory authority on behalf of one or more universities described in section 501(c)(3) of the 1986 Code or a foundling hospital, and

(ii) the application by the university for the issuance of such bond was made before October 27, 1985.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $150,000,000. In the case of bonds to which this paragraph applies, the requirements of sections 148 and 149(d) of the 1986 Code shall be treated as included in section 103 of the 1954 Code and shall apply to such bonds.

(O) Any bond to which section 145(b) of the 1986 Code does not apply by reason of this section shall be taken into account in determining whether such section applies to any later issue.

(34) ARBITRAGE REBATE.—Section 148(f) of the 1986 Code shall not apply to any period before October 1, 1990, with respect to any bond the proceeds of which are to be used to provide a high-speed rail system for the State of Ohio. The aggregate face amount of bonds to which this paragraph applies shall not exceed $2,000,000,000.

(35) EXTENSION OF CARRYFORWARD PERIOD.—

(A) In the case of a carryforward under section 103(n)(10) of the 1954 Code of $170,000,000 of bond limit for calendar year 1984 for a project described in subparagraph (B), clause (i) of section 103(n)(10)(C) of the 1954 Code shall be applied by substituting "6 calendar years" for "3 calendar years", and such carryforward may be used by any authority designated by the State in which the facility is located.

(B) A project is described in this subparagraph if—

(i) such project is a facility for local furnishing of electricity described in section 645 of the Tax Reform Act of 1984, and

(ii) construction of such facility commenced within the 3-year period following the calendar year in which the carryforward arose.

(36) POWER PURCHASE BONDS.—A bond issued to finance purchase of power from a power facility at a dam being renovated pursuant to P.L. 98–381 shall not be treated as a private activity bond if it would not be such under section 141(b)(1) and (2) of the 1986 Code if 25 percent were substituted for 10 percent and the provisions of section 141(b) (3), (4), and (5) of the 1986 Code did not apply. The aggregate face amount of bonds to which this paragraph applies shall not exceed $80,000,000.

(37) QUALIFIED MORTGAGE BONDS.—A bond issued as part of either of 2 issues no later than September 8, 1986, shall be treated as a qualified mortgage bond within the meaning of section 141(d)(1)(B) of the 1986 Code if it satisfies the requirements of section 103A of the 1954 Code and if the issues are issued by the two most populous cities in the Tar Heel State. The aggregate face amount of bonds to which this paragraph applies shall not exceed $4,000,000.

(38) EXEMPT FACILITY BONDS.—A bond shall be treated as an exempt facility bond within the meaning of section 142(a) of the 1986 Code if it is issued to fund residential, office, retail, light industrial, recreational and parking development known as Tobacco Row. Such bond shall be subject to section 146 and sections 148 and 149 of the 1986 Code. The aggregate face amount of bonds to which this paragraph applies shall not exceed $100,000,000.

(39) CERTAIN WASTEWATER TREATMENT FACILITY.—A bond shall not be subject to the provisions of section 146 of the 1986 Code if it is issued to acquire and complete a wastewater treatment facility—

(A) which was organized by an inter-local agreement dated October 17, 1978,

(B) for which $78,143,557 has been spent as of July 31, 1986, and

(C) for which the first construction contract was let on February 27, 1981.

The aggregate face amount of bonds to which this paragraph applies shall not exceed $100,000,000.

(40) REFUNDING OF CERTAIN TAXABLE DEBT.—A bond issued to refinance taxable debt shall not be treated as a qualified 501(c)(3) bond within the meaning of section 141(d)(1)(G) of the 1986 Code if an authorizing resolution as adopted by the issuer on August 14, 1986, for St. Mary's Hospital. The aggregate face amount of bonds to which this paragraph applies shall not exceed $22,314,000.

(41) TIME TO MATURITY FOR CERTAIN OBLIGATIONS.—The requirement of section 147(b) of the 1986 Code shall apply to current refunding bonds issued with respect to two power facilities on which construction has been suspended by measuring the economic life of the facilities from the date of the refunding bonds if the facilities have not been placed in service as of the date of issuance of the refunding bonds. The aggregate face amount of bonds to which this paragraph applies shall not exceed $2,000,000,000.

(42) RESIDENTIAL RENTAL PROPERTY.—A bond issued to finance a residential rental project within the meaning of 103(b)(4) of the 1954 Code shall be treated as an exempt facility bond within the meaning of section 142(a)(7) of the 1986 Code if the county housing finance authority adopted an inducement resolution with respect to the project on May 8, 1985, and the project is located in Polk County, Florida. The aggregate face amount of bonds to which this paragraph applies shall not exceed $4,100,000.

(43) EXTENSION OF ADVANCE REFUNDING FOR CERTAIN FACILITIES.—Paragraph (4) of section 631(c) of the Tax Reform Act of 1984 is amended—

(A) by striking out the second sentence thereof,

(B) by adding at the end thereof the following new sentence: "In the case of refunding obligations not exceeding $100,000,000 issued by the Alabama State Docks Department, the first sentence of this paragraph shall be applied by substituting "December 31, 1987" for "December 31, 1984".

(44) POOL BONDS.—The following amounts of pool bonds are exempt from the arbitrage rebate requirement of section 148(f) of the 1986 Code:

Pool	*Maximum Bond Amount*
Tennessee Utility Districts Pool	*$80,000,000*
New Mexico Hospitals Bond Pool	*$35,000,000*
Pennsylvania Local Government Investment Trust Pool	*$375,000,000*
Indiana Bond Bank Pool	*$240,000,000*
Hernando County, Florida Bond Pool	*$300,000,000*
Utah Municipal Finance Cooperative Pool	*$262,000,000*
North Carolina League of Municipalities Pool	*$200,000,000*
Kentucky Municipal League Bond Pool	*$170,000,000*
Kentucky Association of Counties Bond Pool	*$100,000,000*
Homewood Municipal Bond Pool	*$50,000,000*
Colorado Association of School Boards Pool	*$300,000,000*
Tennessee Municipal League Pooled Bonds	*$75,000,000*
Georgia Municipal Association Pool	*$130,000,000*

(45) CERTAIN CARRYFORWARD ELECTIONS.—Notwithstanding any other provision of this title—

(A) In the case of a metropolitan service district created pursuant to State revised statutes, chapter 268, up to $100,000,000 unused 1985 bond authority may be carried forward to any year until 1989 (regardless of the date on which such carryforward election is made).

(B) If—

(i) official action was taken by an industrial development board on September 16, 1985, with respect to the issuance of not more than $98,500,000, of waste water treatment revenue bonds, and

(ii) an executive order of the governor granted a carryforward of State bond authority for such project on December 30, 1985,

such carryforward election shall be valid for any year through 1988. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $98,500,000.

(46) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE HYDROELECTRIC GENERATING FACILITY.—If

(A) obligations are issued in an amount not exceeding $5,000,000 to finance the construction of a hydroelectric b generating facility located on the North Fork of Cache Creek in Lake County, California, which was the subject of a preliminary resolution of the issuer of the obligations on June 29, 1982, or are issued to refund any of such obligations,

(B) substantially all of the electrical power generated by such facility is to be sold to a nongovernmental person pursuant to a long-term power sales agreement in accordance with the Public Utility Regulatory Policies Act of 1978, and

(C) the initially issued obligations are issued on or before December 31, 1986, and any of such refunding obligations are issued on or before December 31, 1996,

then the person referred to in subparagraph (B) shall not be treated as a principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the 1954 Code.

(47) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE STEAM AND ELECTRIC COGENERATION FACILITY.—If—

(A) obligations are issued on or before December 31, 1986, in an amount not exceeding $4,400,000 to finance a facility for the generation and transmission of steam and electricity having a maximum electrical capacity of approximately 5.3 megawatts and located within the City of San Jose, California, or are issued to refund any of such obligations,

(B) substantially all of the electrical power generated by such facility that is not sold to an institution of higher education created by statute of the State of California is to be sold to a nongovernmental person pursuant to a long-term power sales agreement in accordance with the Public Utility Regulatory Policies Act of 1978, and

(C) the initially issued obligations are issued on or before December 31, 1986, and any of such refunding obligations are issued on or before December 31, 1996,

then the nongovernmental person referred to in subparagraph (B) shall not be treated as a principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the Internal Revenue Code of 1954.

(48) TREATMENT OF CERTAIN OBLIGATIONS.—A bond which is not an industrial development bond under section 103(b)(2) of the Internal Revenue Code of 1954 shall not be treated as a private activity bond for purposes of part IV of subchapter B of chapter 1 of the 1986 Code if 95 percent or more of the net proceeds of the issue of which such bond is a part are used to provide facilities described in either of the following subparagraphs:

(A) A facility is described in this subparagraph if it is a governmentally-owned and operated State fair and exposition center with respect to which—

(i) the 1985 session of the State legislature authorized revenue bonds to be issued in a maximum amount of $10,000,000, and

(ii) a market feasibility study dated June 30, 1986, relating to a major capital improvemental program at the facility was prepared for the advisory board of the State fair and exposition center by a certified public accounting firm.

The aggregate face amount of obligations to which this subparagraph applies shall not exceed $10,000,000.

(B) A facility is described in this subparagraph if it is a convention, trade, or spectator facility which is to be located in the State with respect to which subparagraph (O) applies and with respect to which feasibility and preliminary design consultants were hired on May 1, 1985 and October 31, 1985. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $175,000,000.

(49) Transition rule for refunding certain housing bonds.—Sections *146 and 149(d) for the 1986 Code shall not apply to the refunding of any bond issued under section 11(b) of the Housing Act of 1937 before December 31, 1983, if—*

(A) the bond has an original term to maturity of at least 40 years,

(B) the maturity date of the refunding bonds does not exceed the maturity date of the refunded bonds,

(C) the amount of the refunding bonds does not exceed the outstanding amount of the refunded bonds,

(D) the interest rate on the refunding bonds is lower than the interest rate of the refunded bonds, and

(E) the refunded bond is required to be redeemed not later than the earliest date on which such bond could be redeemed at par.

(50) Transition bonds subject to certain rules.—In the case of any bond to which any provision of this subsection applies—

(A) Minimum tax treatment.—Any bond which, without regard to this section, would be a private activity bond (as defined in section 141(a) of the 1986 Code) shall be so treated for purposes of section 55 of such Code unless such bond would not be described in section 103(b)(2) or (o)(2) of the 1954 Code were such bond issued before August 16, 1986.

(B) Certain restrictions apply.—Except as otherwise expressly provided, sections 103 and 103A of the 1954 Code shall be applied as if the requirements of section 148 and subsection (d) and (g) of section 149 of the 1986 Code were included in each such section.

(51) Certain additional projects.—Section 141(a) of the 1986 Code shall be applied by substituting "25" for "10" each place it appears and by not applying sections 141(a)(3) and 141(c)(1)(B) to bonds substantially all of the proceeds are used for—

(A) A project is described in this subparagraph if it consists of a capital improvements program for a metropolitan sewer district, with respect to which a proposition was submitted to voters on August 7, 1984. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $60,000,000.

(B) Facilities described in this subparagraph if it consists of additions, extensions, and improvements to the wastewater system for Lakeland, Florida. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $20,000,000.

(C) A project is described in this subparagraph if it is the Central Valley Water Reclamation Project in Utah. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $100,000,000.

(D) A project is described in this subparagraph if it is a project to construct approximately 26 miles of toll expressways, with respect to which any appeal to validation was filed July 11, 1986. The aggregate face amount of obligations to which this subparagraph applies shall not exceed $450,000,000.

(52) TERMINATION.—This section shall not apply to any bond issued after December 31, 1990.

SEC. 1318. DEFINITIONS, ETC., RELATING TO EFFECTIVE DATES AND TRANSITIONAL RULES.

For purposes of this subtitle—

(1) 1954 CODE.—The term "1954 Code" means the Internal Revenue Code of 1954 as in effect on the day before the date of the enactment of this Act.

(2) 1986 CODE.—The term "1986 Code" means the Internal Revenue Code of 1986 as amended by this Act.

(3) BOND.—The term "bond" includes any obligation.

(4) ADVANCE REFUND.—A bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

(5) NET PROCEEDS.—The term "net proceeds" has the meaning given such term by section 150(a) of the 1986 Code.

(6) CONTINUED APPLICATION OF THE 1954 CODE.—Nothing in this subtitle shall be construed to exempt any bond from any provision of the 1954 Code by reason of a delay in (or exemption from) the application of any amendment made by subtitle A.

(7) TREATMENT AS EXEMPT FACILITY.—Any bond which is treated as an exempt facility bond by section 1316 or 1317 shall not fail to be so treated by reason of subsection (b) of section 142 of the 1986 Code.

TITLE XIV—TRUSTS AND ESTATES; UNEARNED INCOME OF CERTAIN MINOR CHILDREN; GIFT AND ESTATE TAXES; GENERATION-SKIPPING TRANSFER TAX

Subtitle A—Income Taxation of Trusts and Estates

SEC. 1401. GRANTOR TREATED AS HOLDING ANY POWER OR INTEREST OF GRANTOR'S SPOUSE.

(a) IN GENERAL.—Section 672 (relating to definitions and rules) is amended by adding at the end thereof the following new subsection:

"(e) GRANTOR TREATED AS HOLDING ANY POWER OR INTEREST OF GRANTOR'S SPOUSE.—For purposes of this subpart, if a grantor's spouse is living with the grantor at the time of the creation of any

power or interest held by such spouse, the grantor shall be treated as holding such power or interest."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply with respect to transfers in trust made after March 1, 1986.

SEC. 1402. LIMITATIONS TO REVERSIONARY INTEREST RULE EXCEPTIONS.

(a) IN GENERAL.—Section 673 (relating to reversionary interest) is amended to read as follows:

"SEC. 673. REVERSIONARY INTERESTS.

"(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

"(b) REVERSIONARY INTEREST TAKING EFFECT AT DEATH OF MINOR LINEAL DESCENDANT BENEFICIARY.—In the case of any beneficiary who—

"(1) is a lineal descendant of the grantor, and

"(2) holds all of the present interests in any portion of a trust,

the grantor shall not be treated under subsection (a) as the owner of such portion solely by reason of a reversionary interest in such portion which takes effect upon the death of such beneficiary before such beneficiary attains age 21."

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 674(b) (relating to exceptions for certain powers) is amended—

(A) by striking out "the expiration of a period" and inserting in lieu thereof "the occurrence of an event",

(B) by striking out "the expiration of the period" and inserting in lieu thereof "the occurrence of the event", and

(C) by striking out "EXPIRATION OF 10-YEAR PERIOD" in the heading thereof and inserting in lieu thereof "OCCURRENCE OF EVENT".

(2) Subsection (b) of section 676 (relating to power to revoke) is amended—

(A) by striking out "the expiration of a period" and inserting in lieu thereof "the occurrence of an event",

(B) by striking out "the expiration of such period" and inserting in lieu thereof "the occurrence of such event", and

(C) by striking out "EXPIRATION OF 10-YEAR PERIOD" in the heading thereof and inserting in lieu thereof "OCCURRENCE OF EVENT".

(3) Subsection (a) of section 677 (relating to income for benefit of grantor) is amended—

(A) by striking out "the expiration of a period" and inserting in lieu thereof "the occurrence of an event", and

(B) by striking out "the expiration of the period" and inserting in lieu thereof "the occurrence of the event".

(c) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply with respect to transfers in trust made after March 1, 1986.

(2) TRANSFERS PURSUANT TO PROPERTY SETTLEMENT AGREEMENT.—The amendments made by this section shall not apply

to any transfer in trust made after March 1, 1986, pursuant to a binding property settlement agreement entered into on or before March 1, 1986, which required the taxpayer to establish a grantor trust and for the transfer of a specified sum of money or property to the trust by the taxpayer. This paragraph shall apply only to the extent of the amount required to be transferred under the agreement described in the preceding sentence.

SEC. 1403. TAXABLE YEAR OF TRUSTS TO BE CALENDAR YEAR.

(a) In General.—Subpart A of part I of subchapter J of chapter 1 (relating to general rules for taxation of estates and trusts) is amended by adding at the end thereof the following new section:

"SEC. 645. TAXABLE YEAR OF TRUSTS.

"(a) In General.—For purposes of this subtitle, the taxable year of any trust shall be the calendar year.

"(b) Exception for Trusts Exempt From Tax and Charitable Trusts.—Subsection (a) shall not apply to a trust exempt from taxation under section 501(a) or to a trust described in section 4947(a)(1)."

(b) Clerical Amendment.—The table of sections of subpart A of part I of subchapter J of chapter 1 is amended by adding at the end thereof the following new item:

"Sec. 645. Taxable year of trusts."

(c) Effective Date; Transition Rule.—

(1) Effective date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

(2) Transition rule.—With respect to any trust beneficiary who is required to include in gross income amounts under sections 652(a) or 662(a) of the Internal Revenue Code of 1986 in the 1st taxable year of the beneficiary beginning after December 31, 1986, by reason of any short taxable year of the trust required by the amendments made by this section, such income shall be ratably included in the income of the trust beneficiary over the 4-taxable year period beginning with such taxable year.

SEC. 1404. TRUSTS AND CERTAIN ESTATES TO MAKE ESTIMATED PAYMENTS OF INCOME TAXES.

(a) In General.—Subsection (k) of section 6654 (relating to failure by individual to pay estimated income tax) is amended to read as follows:

"(k) Trusts and Certain Estates.—This section shall apply to—

"(1) any trust, and

"(2) any estate with respect to any taxable year ending 2 or more years after the date of the death of the decedent's death."

(b) Certain Payments of Estimated Tax by a Trust.—Section 643 is amended by adding at the end thereof the following new subsection:

"(g) Certain Payments of Estimated Tax Treated as Paid by Beneficiary.—

"(1) In general.—In the case of a trust—

"(A) the trustee may elect to treat any portion of a payment of estimated tax made by such trust for any taxable year of the trust as a payment made by a beneficiary of such trust,

"(B) any amount so treated shall be treated as paid or credited to the beneficiary on the last day of such taxable year, and

"(C) for purposes of subtitle F, the amount so treated—

"(i) shall not be treated as a payment of estimated tax made by the trust, but

"(ii) shall be treated as a payment of estimated tax made by such beneficiary on January 15 following the taxable year.

The preceding sentence shall apply only to the extent the payments of estimated tax made by the trust for the taxable year exceed the tax imposed by this chapter shown on its return for the taxable year.

"(2) Time for making election.—An election under paragraph (1) may be made—

"(A) only on the trust's return of the tax imposed by this chapter for the taxable year, and

"(B) only if such return is filed on or before the 65th day after the close of the taxable year."

(c) Conforming Amendments.—

(1) Section 6152 (relating to installment payments) is repealed.

(2) Section 6215(b) (relating to cross references) is amended by striking out paragraph (7) and redesignating paragraph (8) as paragraph (7).

(3) Paragraph (2) of section 6601 (relating to last date prescribed for payment) is amended—

(A) by striking out "6152(a), 6156(a), or 6158(a)" and inserting in lieu thereof "6156(a) or 6158(a)", and

(B) by striking out "6152(b), 6156(b), or 6158(a)" in subparagraph (A) and inserting in lieu thereof "6156(b) or 6158(a)".

(4) The table of sections for subchapter A of chapter 62 is amended by striking out the item relating to section 6152.

(d) Effective Date.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

Subtitle B—Unearned Income of Certain Minor Children

SEC. 1411. UNEARNED INCOME OF CERTAIN MINOR CHILDREN.

(a) General Rule.—Section 1, as amended by section 101, is amended by inserting after subsection (h) the following new subsection:

"(i) Certain Unearned Income of Minor Children Taxed as if Parent's Income.—

"(1) In general.—In the case of any child to whom this subsection applies, the tax imposed by this section shall be equal to the greater of—

"(A) the tax imposed by this section without regard to this subsection, or

"(B) the sum of—

"(i) the tax which would be imposed by this section if the taxable income of such child for the taxable year were reduced by the net unearned income of such child, plus

"(ii) such child's share of the allocable parental tax.

"(2) CHILD TO WHOM SUBSECTION APPLIES.—This subsection shall apply to any child for any taxable year if—

"(A) such child has not attained age 14 before the close of the taxable year, and

"(B) either parent of such child is alive at the close of the taxable year.

"(3) ALLOCABLE PARENTAL TAX.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'allocable parental tax' means the excess of—

"(i) the tax which would be imposed by this section on the parent's taxable income if such income included the net unearned income of all children of the parent to whom this subsection applies, over

"(ii) the tax imposed by this section on the parent without regard to this subsection.

For purposes of clause (i), net unearned income of all children of the parent shall not be taken into account in computing any deduction or credit of the parent.

"(B) CHILD'S SHARE.—A child's share of any allocable parental tax of a parent shall be equal to an amount which bears the same ratio to the total allocable parental tax as the child's net unearned income bears to the aggregate net unearned income of all children of such parent to whom this subsection applies.

"(4) NET UNEARNED INCOME.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'net unearned income' means the excess of—

"(i) the portion of the gross income for the taxable year which is not earned income (as defined in section 911(d)(2)), over

"(ii) the sum of—

"(I) the amount in effect for the taxable year under section 63(c)(5)(A) (relating to limitation on standard deduction in the case of certain dependents), plus

"(II) the greater of the amount described in subclause (I) or, if the child itemizes his deduction for the taxable year, the amount of the deductions allowed by this chapter for the taxable year which are directly connected with the production of the portion of gross income referred to in clause (i).

"(B) LIMITATION BASED ON TAXABLE INCOME.—The amount of the net unearned income for any taxable year shall not exceed the individual's taxable income for such taxable year.

"(5) SPECIAL RULES FOR DETERMINING PARENT TO WHOM SUBSECTION APPLIES.—For purposes of this subsection, the parent whose taxable income shall be taken into account shall be—

"(A) in the case of parents who are not married (within the meaning of section 7703), the custodial parent of the child, and

"(B) in the case of married individuals filing separately, the individual with the greater taxable income.

"(6) PROVIDING OF PARENT'S TIN.—The parent of any child to whom this subsection applies for any taxable year shall provide the TIN of such parent to such child and such child shall include such TIN on the child's return of tax imposed by this section for such taxable year."

(b) DISCLOSURE OF INFORMATION.—Subparagraph (A) of section 6103(e)(1) (relating to disclosure to persons having material interest) is amended by striking out "or" at the end of clause (ii), by inserting "or" at the end of clause (iii), and by adding at the end thereof the following new clause:

"(iv) the child of that individual (or such child's legal representative) to the extent necessary to comply with the provisions of section 1(j);".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

Subtitle C—Gift and Estate Taxes

SEC. 1421. INFORMATION NECESSARY FOR VALID SPECIAL USE VALUATION ELECTION.

(a) IN GENERAL.—In the case of any decedent dying before January 1, 1986, if the executor—

(1) made an election under section 2032A of the Internal Revenue Code of 1954 on the return of tax imposed by section 2001 of such Code within the time prescribed for filing such return (including extensions thereof), and

(2) provided substantially all the information with respect to such election required on such return of tax,

such election shall be a valid election for purposes of section 2032A of such Code.

(b) EXECUTOR MUST PROVIDE INFORMATION.—An election described in subsection (a) shall not be valid if the Secretary of the Treasury or his delegate after the date of the enactment of this Act requests information from the executor with respect to such election and the executor does not provide such information within 90 days of receipt of such request.

(c) EFFECTIVE DATE.—The provisions of this section shall not apply to the estate of any decedent if before the date of the enactment of this Act the statute of limitations has expired with respect to—

(1) the return of tax imposed by section 2001 of the Internal Revenue Code of 1954, and

(2) the period during which a claim for credit or refund may be timely filed.

(d) SPECIAL RULE FOR CERTAIN ESTATE.—Notwithstanding subsection (a)(2), the provisions of this section shall apply to the estate of an individual who died on January 30, 1984, and with respect to which—

(1) a Federal estate tax return was filed on October 30, 1984, electing current use valuation, and

(2) the agreement required under section 2032A was filed on November 9, 1984.

SEC. 1422. GIFT AND ESTATE TAX DEDUCTIONS FOR CERTAIN CONSERVATION EASEMENT DONATIONS.

(a) ESTATE TAX.—Section 2055 (relating to transfers for public, charitable, and religious uses) is amended—

(1) by redesignating subsection (f) as subsection (g), and

(2) by inserting after subsection (e) the following new subsection:

"(f) SPECIAL RULE FOR IRREVOCABLE TRANSFERS OF EASEMENTS IN REAL PROPERTY.—A deduction shall be allowed under subsection (a) in respect of any transfer of a qualified real property interest (as defined in section 170(h)(2)(C)) which meets the requirements of section 170(h) (without regard to paragraph (4)(A) thereof)."

(b) GIFT TAX.—Section 2522 (relating to charitable and similar gifts) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) SPECIAL RULE FOR IRREVOCABLE TRANSFERS OF EASEMENTS IN REAL PROPERTY.—A deduction shall be allowed under subsection (a) in respect of any transfer of a qualified real property interest (as defined in section 170(h)(2)(C)) which meets the requirements of section 170(h) (without regard to paragraph (4)(A) thereof)."

(c) CONFORMING AMENDMENT.—Subparagraph (F)(ii) of section 2106(a)(2) is amended by striking out "section 2055(f)" and inserting in lieu thereof "section 2055(g)".

(d) SPECIAL DONATIONS.—If the Secretary of the Interior acquires by donation after December 31, 1986, a conservation easement (within the meaning of section 2(h) of S. 720, 99th Congress, 1st Session, as in effect on August 16, 1986), such donation shall qualify for treatment under section 2055(f) or 2522(d) of the Internal Revenue Code of 1954, as added by this section.

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers and contributions made after December 31, 1986.

SEC. 1423. CONVEYANCE OF CERTAIN REAL AND PERSONAL PROPERTY OF DECEDENT TO CHARITABLE FOUNDATION TREATED AS CHARITABLE CONTRIBUTION.

Notwithstanding any other law or any rule of law (including res judicata, laches, or lapse of time), in the case of any real property or personal property located in Bangkok, Thailand, which—

(1) was owned by James H.W. Thompson at the time of his death, and

(2) has been transferred to the Jim Thompson Foundation (also known as the J.H.W. Thompson Foundation), a charitable foundation established in Thailand for the purpose of operating a museum consisting of such real and personal property,

such property shall be treated, for purposes of section 2055 of the Internal Revenue Code of 1954 (relating to deductions for transfers for public, charitable, and religious uses), as having been transferred as a bequest or a devise directly from the estate of James H.W. Thompson to the Jim Thompson Foundation and the value of such property included in the gross estate shall be deducted from the gross estate of James H.W. Thompson for purposes of the tax imposed by section 2001 of such Code.

Subtitle D—Generation-Skipping Transfers

SEC. 1431. NEW TAX ON GENERATION-SKIPPING TRANSFERS.

(a) General Rule.—Chapter 13 (relating to tax on certain generation-skipping transfers) is amended to read as follows:

"CHAPTER 13—TAX ON GENERATION-SKIPPING TRANSFERS

"Subchapter A. Tax imposed.
"Subchapter B. Generation-skipping transfers.
"Subchapter C. Taxable amount.
"Subchapter D. GST exemption.
"Subchapter E. Applicable rate; inclusion ratio.
"Subchapter F. Other definitions and special rules.
"Subchapter G. Administration.

"Subchapter A—Tax Imposed

"Sec. 2601. Tax imposed.
"Sec. 2602. Amount of tax.
"Sec. 2603. Liability for tax.
"Sec. 2604. Credit for certain State taxes.

"SEC. 2601. TAX IMPOSED.

"A tax is hereby imposed on every generation-skipping transfer (within the meaning of subchapter B).

"SEC. 2602. AMOUNT OF TAX.

"The amount of the tax imposed by section 2601 is—

"(1) the taxable amount (determined under subchapter C), multiplied by

"(2) the applicable rate (determined under subchapter E).

"SEC. 2603. LIABILITY FOR TAX.

"(a) Personal Liability.—

"(1) Taxable distributions.—In the case of a taxable distribution, the tax imposed by section 2601 shall be paid by the transferee.

"(2) Taxable termination.—In the case of a taxable termination or a direct skip from a trust, the tax shall be paid by the trustee.

"(3) Direct skip.—In the case of a direct skip (other than a direct skip from a trust), the tax shall be paid by the transferor.

"(b) Source of Tax.—Unless otherwise directed pursuant to the governing instrument by specific reference to the tax imposed by this chapter, the tax imposed by this chapter on a generation-skipping transfer shall be charged to the property constituting such transfer.

"(c) Cross Reference.—

"For provisions making estate and gift tax provisions with respect to transferee liability, liens, and related matters applicable to the tax imposed by section 2601, see section 2661.

"SEC. 2604. CREDIT FOR CERTAIN STATE TAXES.

"(a) General Rule.—If a generation-skipping transfer (other than a direct skip) occurs at the same time as and as a result of the death of an individual, a credit against the tax imposed by section 2601 shall be allowed in an amount equal to the generation-skipping transfer tax actually paid to any State in respect to any property included in the generation-skipping transfer.

"(b) Limitation.—The aggregate amount allowed as a credit under this section with respect to any transfer shall not exceed 5 percent of the amount of the tax imposed by section 2601 on such transfer.

"Subchapter B—Generation-Skipping Transfers

"Sec. 2611. Generation-skipping transfer defined.
"Sec. 2612. Taxable termination; taxable distribution; direct skip.
"Sec. 2613. Skip person and non-skip person defined.

"SEC. 2611. GENERATION-SKIPPING TRANSFER DEFINED.

"(a) In General.—For purposes of this chapter, the term 'generation-skipping transfers' mean—

"(1) a taxable distribution,

"(2) a taxable termination, and

"(3) a direct skip.

"(b) Certain Transfers Excluded.—The term 'generation-skipping transfer' does not include—

"(1) any transfer (other than a direct skip) from a trust, to the extent such transfer is subject to a tax imposed by chapter 11 or 12 with respect to a person in the 1st generation below that of the grantor, and

"(2) any transfer which, if made inter vivos by an individual, would not be treated as a taxable gift by reason of section 2503(e) (relating to exclusion of certain transfers for educational or medical expenses), and

"(3) any transfer to the extent—

"(A) the property transferred was subject to a prior tax imposed under this chapter,

"(B) the transferee in the prior transfer was assigned to the same generation as (or a lower generation than) the generation assignment of the transferee in this transfer, and

"(C) such transfers do not have the effect of avoiding tax under this chapter with respect to any transfer.

"SEC. 2612. TAXABLE TERMINATION; TAXABLE DISTRIBUTION; DIRECT SKIP.

"(a) Taxable Termination.—

"(1) General rule.—For purposes of this chapter, the term 'taxable termination' means the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless—

"(A) immediately after such termination, a non-skip person has an interest in such property, or

"(B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

"(2) Certain partial terminations treated as taxable.—If, upon the termination of an interest in property held in a trust, a specified portion of the trust assets are distributed to skip persons who are lineal descendants of the holder of such interest (or to 1 or more trusts for the exclusive benefit of such persons), such termination shall constitute a taxable termination with respect to such portion of the trust property.

"(b) Taxable Distribution.—For purposes of this chapter, the term 'taxable distribution' means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

"(c) Direct Skip.—For purposes of this chapter—

"(1) In general.—The term 'direct skip' means a transfer subject to a tax imposed by chapter 11 or 12 of an interest in property to a skip person.

"(2) Special rule for transfers to grandchildren.—For purposes of determining whether any transfer is a direct skip, if—

"(A) an individual is a grandchild of the transferor (or the transferor's spouse or former spouse), and

"(B) as of the time of the transfer, the parent of such individual who is a lineal descendant of the transferor (or the transferor's spouse or former spouse) is dead,

such individual shall be treated as if such individual were a child of the transferor and all of that grandchild's children shall be treated as if they were grandchildren of the transferor. In the case of lineal descendants below a grandchild, the preceding sentence may be reapplied.

"SEC. 2613. SKIP PERSON AND NON-SKIP PERSON DEFINED.

"(a) Skip Person.—For purposes of this chapter, the term 'skip person' means—

"(1) a person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or

"(2) a trust—

"(A) if all interests in such trust are held by skip persons, or

"(B) if—

"(i) there is no person holding an interest in such trust, and

"(ii) at no time after such transfer may a distribution (including distributions on termination) be made from such trust to a nonskip person.

"(b) Non-Skip Person.—For purposes of this chapter, the term 'non-skip person' means any person who is not a skip person.

"Subchapter C—Taxable Amount

"Sec. 2621. Taxable amount in case of taxable distribution.
"Sec. 2622. Taxable amount in case of taxable termination.
"Sec. 2623. Taxable amount in case of direct skip.
"Sec. 2624. Valuation.

"SEC. 2621. TAXABLE AMOUNT IN CASE OF TAXABLE DISTRIBUTION.

"(a) In General.—For purposes of this chapter, the taxable amount in the case of any taxable distribution shall be—

"(1) the value of the property received by the transferee, reduced by

"(2) any expense incurred by the transferee in connection with the determination, collection, or refund of the tax imposed by this chapter with respect to such distribution.

"(b) Payment of GST Tax Treated as Taxable Distribution.—For purposes of this chapter, if any of the tax imposed by this chapter with respect to any taxable distribution is paid out of the trust,

an amount equal to the portion so paid shall be treated as a taxable distribution.

"SEC. 2622. TAXABLE AMOUNT IN CASE OF TAXABLE TERMINATION.

"(a) In General.—For purposes of this chapter, the taxable amount in the case of a taxable termination shall be—

"(1) the value of all property with respect to which the taxable termination has occurred, reduced by

"(2) any deduction allowed under subsection (b).

"(b) Deduction for Certain Expenses.—For purposes of subsection (a), there shall be allowed a deduction similar to the deduction allowed by section 2053 (relating to expenses, indebtedness, and taxes) for amounts attributable to the property with respect to which the taxable termination has occurred.

"SEC. 2623. TAXABLE AMOUNT IN CASE OF DIRECT SKIP.

"For purposes of this chapter, the taxable amount in the case of a direct skip shall be the value of the property received by the transferee.

"SEC. 2624. VALUATION.

"(a) General Rule.—Except as otherwise provided in this chapter, property shall be valued as of the time of the generation-skipping transfer.

"(b) Alternate Valuation and Special Use Valuation Elections Apply To Certain Direct Skips.—In the case of any direct skip of property which is included in the transferor's gross estate, the value of such property for purposes of this chapter shall be the same as its value for purposes of chapter 11 (determined with regard to sections 2032 and 2032A).

"(c) Alternate Valuation Election Permitted in the Case of Taxable Terminations Occurring at Death.—If 1 or more taxable terminations with respect to the same trust occur at the same time as and as a result of the death of an individual, an election may be made to value all of the property included in such terminations in accordance with section 2032.

"(d) Reduction for Consideration Provided by Transferee.—For purposes of this chapter, the value of the property transferred shall be reduced by the amount of any consideration provided by the transferee.

"Subchapter D—GST Exemption

"Sec. 2631. GST exemption.
"Sec. 2632. Special rules for allocation of GST exemption.

"SEC. 2631. GST EXEMPTION.

"(a) General Rule.—For purposes of determining the inclusion ratio, every individual shall be allowed a GST exemption of $1,000,000 which may be allocated by such individual (or his executor) to any property with respect to which such individual is the transferor.

"(b) Allocations Irrevocable.—Any allocation under subsection (a), once made, shall be irrevocable.

"SEC. 2632. SPECIAL RULES FOR ALLOCATION OF GST EXEMPTION.

"(a) Time and Manner of Allocation.—

"(1) Time.—Any allocation by an individual of his GST exemption under section 2631(a) may be made at any time on or before the date prescribed for filing the estate tax return for such individual's estate (determined with regard to extensions), regardless of whether such a return is required to be filed.

"(2) Manner.—The Secretary shall prescribe by forms or regulations the manner in which any allocation referred to in paragraph (1) is to be made.

"(b) Deemed Allocation to Certain Lifetime Direct Skips.—

"(1) In general.—If any individual makes a direct skip during his lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the direct skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

"(2) Unused portion.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been allocated by such individual (or treated as allocated under paragraph (1)) with respect to a prior direct skip.

"(3) Subsection not to apply in certain cases.—An individual may elect to have this subsection not apply to a transfer.

"(c) Allocation of Unused GST Exemption.—

"(1) In general.—Any portion of an individual's GST exemption which has not been allocated within the time prescribed by subsection (a) shall be deemed to be allocated as follows—

"(A) first, to property which is the subject of a direct skip occurring at such individual's death, and

"(B) second, to trusts with respect to which such individual is the transferor and from which a taxable distribution or a taxable termination might occur at or after such individual's death.

"(2) Allocation within categories.—

"(A) In general.—The allocation under paragraph (1) shall be made among the properties described in subparagraph (A) thereof and the trusts described in subparagraph (B) thereof, as the case may be, in proportion to the respective amounts (at the time of allocation) of the nonexempt portions of such properties or trusts.

"(B) Nonexempt portion.—For purposes of subparagraph (A), the term 'nonexempt portion' means the value (at the time of allocation) of the property or trust, multiplied by the inclusion ratio with respect to such property or trust.

"Subchapter E—Applicable Rate; Inclusion Ratio

"Sec. 2641. Applicable rate.
"Sec. 2642. Inclusion ratio.

"SEC. 2641. APPLICABLE RATE.

"(a) General Rule.—For purposes of this chapter, the term 'applicable rate' means, with respect to any generation-skipping transfer, the product of—

"(1) the maximum Federal estate tax rate, and

"(2) the inclusion ratio with respect to the transfer.

"(b) MAXIMUM FEDERAL ESTATE TAX RATE.—For purposes of subsection (a), the term 'maximum Federal estate tax rate' means the maximum rate imposed by section 2001 on the estates of decedents dying at the time of the taxable distribution, taxable termination, or direct skip, as the case may be.

"SEC. 2642. INCLUSION RATIO.

"(a) INCLUSION RATIO DEFINED.—For purposes of this chapter—

"(1) IN GENERAL.—Except as otherwise provided in this section, the inclusion ratio with respect to any property transferred in a generation-skipping transfer shall be the excess (if any) of 1 over—

"(A) except as provided in subparagraph (B), the applicable fraction determined for the trust from which such transfer is made, or

"(B) in the case of a direct skip, the applicable fraction determined for such skip.

"(2) APPLICABLE FRACTION.—For purposes of paragraph (1), the applicable fraction is a fraction—

"(A) the numerator of which is the amount of the GST exemption allocated to the trust (or in the case of a direct skip, allocated to the property transferred in such skip), and

"(B) the denominator of which is—

"(i) the value of the property transferred to the trust (or involved in the direct skip), reduced by

"(ii) the sum of—

"(I) any Federal estate tax or State death tax actually recovered from the trust attributable to such property, and

"(II) any charitable deduction allowed under section 2055 or 2522 with respect to such property.

Except as provided in paragraphs (3) and (4) of subsection (b), the value determined under subparagraph (B)(i) shall be of the property as of the time of the transfer to the trust (or the direct skip).

"(b) VALUATION RULES, ETC.—

"(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any property is made on a timely filed gift tax return required by section 6019 or is deemed to be made under section 2632(b)(1)—

"(A) the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 12, and

"(B) such allocation shall be effective on and after the date of such transfer.

"(2) TRANSFERS AND ALLOCATIONS AT OR AFTER DEATH.—

"(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 11.

"(B) ALLOCATIONS AT OR AFTER DEATH OF TRANSFEROR.—Any allocation at or after the death of the transferor shall be effective on and after the date of the death of the transferor.

"(3) Inter vivos allocations not made on timely filed gift tax return.—If any allocation of the GST exemption to any property is made during the life of the transferor but is not made on a timely filed gift tax return required by section 6019 and is not deemed to be made under section 2632(b)(1)—

"(A) the value of such property for purposes of subsection (a) shall be determined as of the time such allocation is filed with the Secretary, and

"(B) such allocation shall be effective on and after the date on which such allocation is filed with the Secretary.

"(4) QTIP trusts.—If the value of property is included in the estate of a spouse by virtue of section 2044, and if such spouse is treated as the transferor of such property under section 2652(a), the value of such property for purposes of subsection (a) shall be its value for purposes of chapter 11 in the estate of such spouse.

"(c) Treatment of Certain Nontaxable Gifts.—

"(1) Direct skips.—In the case of any direct skip which is a nontaxable gift, the inclusion ratio shall be zero.

"(2) Treatment of nontaxable gifts made to trusts.—

"(A) In general.—Except as provided in subparagraph (B), any nontaxable gift which is not a direct skip and which is made to a trust shall not be taken into account under subsection (a)(2)(B).

"(B) Determination of 1st transfer to trust.—In the case of any nontaxable gift referred to in subparagraph (A) which is the 1st transfer to the trust, the inclusion ratio for such trust shall be zero.

"(3) Nontaxable gift.—For purposes of this section, the term 'nontaxable gift' means any transfer of property to the extent such transfer is not treated as a taxable gift by reason of—

"(A) section 2503(b) (taking into account the application of section 2513), or

"(B) section 2503(e).

"(d) Special Rules Where More Than 1 Transfer Made To Trust.—

"(1) In general.—If a transfer of property (other than a nontaxable gift) is made to a trust in existence before such transfer, the applicable fraction for such trust shall be recomputed as of the time of such transfer in the manner provided in paragraph (2).

"(2) Applicable fraction.—In the case of any such transfer, the recomputed applicable fraction is a fraction—

"(A) the numerator of which is the sum of—

"(i) the amount of the GST exemption allocated to property involved in such transfer, plus

"(ii) the nontax portion of such trust immediately before such transfer, and

"(B) the denominator of which is the sum of—

"(i) the value of the property involved in such transfer, reduced by any charitable deduction allowed under section 2055 or 2522 with respect to such property, and

"(ii) the value of all of the property in the trust (immediately before such transfer).

"(3) NONTAX PORTION.—For purposes of paragraph (2), the term 'nontax portion' means the product of—

"(A) the value of all of the property in the trust, and

"(B) the applicable fraction in effect for such trust.

"(4) SIMILAR RECOMPUTATION IN CASE OF CERTAIN LATE ALLOCATIONS.—If—

"(A) any allocation of the GST exemption to property transferred to a trust is not made on a timely filed gift tax return required by section 6019, and

"(B) there was a previous allocation with respect to property transferred to such trust,

the applicable fraction for such trust shall be recomputed as of the time of such allocation under rules similar to the rules of paragraph (2).

"Subchapter F—Other Definitions and Special Rules

"Sec. 2651. Generation assignment.
"Sec. 2652. Other definitions.
"Sec. 2653. Taxation of multiple skips.
"Sec. 2654. Special rules.

"SEC. 2651. GENERATION ASSIGNMENT.

"(a) IN GENERAL.—For purposes of this chapter, the generation to which any person (other than the transferor) belongs shall be determined in accordance with the rules set forth in this section.

"(b) LINEAL DESCENDANTS.—

"(1) IN GENERAL.—An individual who is a lineal descendant of a grandparent of the transferor shall be assigned to that generation which results from comparing the number of generations between the grandparent and such individual with the number of generations between the grandparent and the transferor.

"(2) ON SPOUSE'S SIDE.—An individual who is a lineal descendant of a grandparent of a spouse of the transferor (other than such spouse) shall be assigned to that generation which results from comparing the number of generations between such grandparent and such individual with the number of generations between such grandparent and such spouse.

"(3) TREATMENT OF LEGAL ADOPTIONS, ETC.—For purposes of this subsection—

"(A) LEGAL ADOPTIONS.—A relationship by legal adoption shall be treated as a relationship by blood.

"(B) RELATIONSHIPS BY HALF-BLOOD.—A relationship by the half-blood shall be treated as a relationship of the whole-blood.

"(c) MARITAL RELATIONSHIP.—

"(1) MARRIAGE TO TRANSFEROR.—An individual who has been married at any time to the transferor shall be assigned to the transferor's generation.

"(2) MARRIAGE TO OTHER LINEAL DESCENDANTS.—An individual who has been married at any time to an individual described in subsection (b) shall be assigned to the generation of the individual so described.

"(d) PERSONS WHO ARE NOT LINEAL DESCENDANTS.—An individual who is not assigned to a generation by reason of the foregoing provisions of this section shall be assigned to a generation on the basis of the date of such individual's birth with—

"(1) an individual born not more than 12½ years after the date of the birth of the transferor assigned to the transferor's generation,

"(2) an individual born more than 12½ years but not more than 37½ years after the date of the birth of the transferor assigned to the first generation younger than the transferor, and

"(3) similar rules for a new generation every 25 years.

"(e) OTHER SPECIAL RULES.—

"(1) INDIVIDUALS ASSIGNED TO MORE THAN 1 GENERATION.—Except as provided in regulations, an individual who, but for this subsection, would be assigned to more than 1 generation shall be assigned to the youngest such generation.

"(2) INTERESTS THROUGH ENTITIES.—Except as provided in paragraph (3), if an estate, trust, partnership, corporation, or other entity has an interest in property, each individual having a beneficial interest in such entity shall be treated as having an interest in such property and shall be assigned to a generation under the foregoing provisions of this subsection.

"(3) TREATMENT OF CERTAIN CHARITABLE ORGANIZATIONS.—Any organization described in section 511(a)(2) and any charitable trust described in section 511(b)(2) shall be assigned to the transferor's generation.

"SEC. 2652. OTHER DEFINITIONS.

"(a) TRANSFEROR.—For purposes of this chapter—

"(1) IN GENERAL.—Except as provided in this subsection or section 2653(a), the term 'transferor' means—

"(A) in the case of a transfer of a kind subject to the tax imposed by chapter 11, the decedent, and

"(B) in the case of a transfer of a kind subject to the tax imposed by chapter 12, the donor.

"(2) GIFT-SPLITTING BY MARRIED COUPLES.—If, under section 2513, one-half of a gift is treated as made by an individual and one-half of such gift is treated as made by the spouse of such individual, such gift shall be so treated for purposes of this chapter.

"(3) SPECIAL ELECTION FOR QUALIFIED TERMINABLE INTEREST PROPERTY.—In the case of—

"(A) any property with respect to which a deduction is allowed to the decedent under section 2056 by reason of subsection (b)(7) thereof, and

"(B) any property with respect to which a deduction to the donor spouse is allowed under section 2523 by reason of subsection (f) thereof,

the estate of the decedent or the donor spouse, as the case may be, may elect to treat such property for purposes of this chapter as if the election to be treated as qualified terminable interest property had not been made.

"(b) TRUST AND TRUSTEE.—

"(1) TRUST.—The term 'trust' includes any arrangement (other than an estate) which, although not a trust, has substantially the same effect as a trust.

"(2) TRUSTEE.—In the case of an arrangement which is not a trust but which is treated as a trust under this subsection, the term 'trustee' shall mean the person in actual or constructive possession of the property subject to such arrangement.

"(3) EXAMPLES.—Arrangements to which this subsection applies include arrangements involving life estates and remainders, estates for years, and insurance and annuity contracts.

"(c) INTEREST.—

"(1) IN GENERAL.—A person has an interest in property held in trust if (at the time the determination is made) such person—

"(A) has a right (other than a future right) to receive income or corpus from the trust,

"(B) is a permissible current recipient of income or corpus from the trust and is not described in section 2055(a), or

"(C) is described in section 2055(a) and the trust is—

"(i) a charitable remainder annuity trust,

"(ii) a charitable remainder unitrust within the meaning of section 664, or

"(iii) a pooled income fund within the meaning of section 642(c)(5).

"(2) CERTAIN NOMINAL INTERESTS DISREGARDED.—For purposes of paragraph (1), an interest which is used primarily to postpone or avoid the tax imposed by this chapter shall be disregarded.

"SEC. 2653. TAXATION OF MULTIPLE SKIPS.

"(a) GENERAL RULE.—For purposes of this chapter, if—

"(1) there is a generation-skipping transfer of any property, and

"(2) immediately after such transfer such property is held in trust,

for purposes of applying this chapter (other than section 2651) to subsequent transfers from the portion of such trust attributable to such property, the trust will be treated as if the transferor of such property were assigned to the 1st generation above the highest generation of any person who has an interest in such trust immediately after the transfer.

"(b) TRUST RETAINS INCLUSION RATIO.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the provisions of subsection (a) shall not affect the inclusion ratio determined with respect to any trust. Under regulations prescribed by the Secretary, notwithstanding the preceding sentence, proper adjustment shall be made to the inclusion ratio with respect to such trust to take into account any tax under this chapter borne by such trust which is imposed by this chapter on the transfer described in subsection (a).

"(2) SPECIAL RULE FOR POUR-OVER TRUST.—

"(A) IN GENERAL.—If the generation-skipping transfer referred to in subsection (a) involves the transfer of property from 1 trust to another trust (hereinafter in this paragraph

referred to as the 'pour-over trust'), the inclusion ratio for the pour-over trust shall be determined by treating the nontax portion of such distribution as if it were a part of a GST exemption allocated to such trust.

"(B) NONTAX PORTION.—For purposes of subparagraph (A), the nontax portion of any distribution is the amount of such distribution multiplied by the applicable fraction which applies to such distribution.

"SEC. 2654. SPECIAL RULES.

"(a) BASIS ADJUSTMENT.—

"(1) IN GENERAL.—Except as provided in paragraph (2), if property is transferred in a generation-skipping transfer, the basis of such property shall be increased (but not above the fair market value of such property) by an amount equal to that portion of the tax imposed by section 2601 (computed without regard to section 2604) with respect to the transfer which is attributable to the excess of the fair market value of such property over its adjusted basis immediately before the transfer.

"(2) CERTAIN TRANSFERS AT DEATH.—If property is transferred in a taxable termination which occurs at the same time as and as a result of the death of an individual, the basis of such property shall be adjusted in a manner similar to the manner provided under section 1014(a); except that, if the inclusion ratio with respect to such property is less than 1, any increase in basis shall be limited by multiplying such increase by the inclusion ratio.

"(b) SEPARATE SHARES TREATED AS SEPARATE TRUSTS.—Substantially separate and independent shares of different beneficiaries in a trust shall be treated as separate trusts.

"(c) DISCLAIMERS.—

"For provisions relating to the effect of a qualified disclaimer for purposes of this chapter, see section 2518.

"(d) LIMITATION ON PERSONAL LIABILITY OF TRUSTEE.—A trustee shall not be personally liable for any increase in the tax imposed by section 2601 which is attributable to the fact that—

"(1) section 2642(c) (relating to exemption of certain nontaxable gifts) does not apply to a transfer to the trust which was made during the life of the transferor and for which a gift tax return was not filed, or

"(2) the inclusion ratio with respect to the trust is greater than the amount of such ratio as computed on the basis of the return on which was made (or was deemed made) an allocation of the GST exemption to property transferred to such trust.

The preceding sentence shall not apply if the trustee has knowledge of facts sufficient reasonably to conclude that a gift tax return was required to be filed or that the inclusion ratio was erroneous.

"Subchapter G—Administration

"Sec. 2661. Administration.
"Sec. 2662. Return requirements.
"Sec. 2663. Regulations.

"SEC. 2661. ADMINISTRATION.

"Insofar as applicable and not inconsistent with the provisions of this chapter—

"(1) except as provided in paragraph (2), all provisions of subtitle F (including penalties) applicable to the gift tax, to chapter 12, or to section 2501, are hereby made applicable in respect of the generation-skipping transfer tax, this chapter, or section 2601, as the case may be, and

"(2) in the case of a generation-skipping transfer occurring at the same time as and as a result of the death of an individual, all provisions of subtitle F (including penalties) applicable to the estate tax, to chapter 11, or to section 2001 are hereby made applicable in respect of the generation-skipping transfer tax, this chapter, or section 2601 (as the case may be).

"SEC. 2662. RETURN REQUIREMENTS.

"(a) IN GENERAL.—The Secretary shall prescribe by regulations the person who is required to make the return with respect to the tax imposed by this chapter and the time by which any such return must be filed. To the extent practicable, such regulations shall provide that—

"(1) the person who is required to make such return shall be the person liable under section 2603(a) for payment of such tax, and

"(2) the return shall be filed—

"(A) in the case of a direct skip (other than from a trust), on or before the date on which an estate or gift tax return is required to be filed with respect to the transfer, and

"(B) in all other cases, on or before the 15th day of the 4th month after the close of the taxable year of the person required to make such return in which such transfer occurs.

"(b) INFORMATION RETURNS.—The Secretary may by regulations require a return to be filed containing such information as he determines to be necessary for purposes of this chapter.

"SEC. 2663. REGULATIONS.

"The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this chapter, including—

"(1) such regulations as may be necessary to coordinate the provisions of this chapter with the recapture tax imposed under section 2032A(c), and

"(2) regulations (consistent with the principles of chapters 11 and 12) providing for the application of this chapter in the case of transferors who are nonresidents not citizens of the United States."

(b) CLERICAL AMENDMENT.—The table of chapters for subtitle B is amended by striking out the item relating to chapter 13 and inserting in lieu thereof the following:

"Chapter 13. Tax on generation-skipping transfers."

SEC. 1432. RELATED AMENDMENTS.

(a) INCOME TAX DEDUCTION FOR GENERATION-SKIPPING TRANSFER TAX.—

(1) In general.—Subsection (a) of section 164 (relating to deduction for certain taxes), as amended by section 134, is amended by inserting after paragraph (4) the following new paragraph:

"(5) the GST tax imposed on income distributions."

(2) Definitions.—Subsection (b) of section 164, as so amended, is amended by adding at the end thereof the following new paragraph:

"(4) Special rules for GST tax.—

"(A) In general.—The GST tax imposed on income distributions is—

"(i) the tax imposed by section 2601, and

"(ii) any State tax described in section 2604,

but only to the extent such tax is imposed on a transfer which is included in the gross income of the distributee and to which section 666 does not apply.

"(B) Special rule for tax paid before due date.—Any tax referred to in subparagraph (A) imposed with respect to a transfer occurring during the taxable year of the distributee (or, in the case of a taxable termination, the trust) which is paid not later than the time prescribed by law (including extensions) for filing the return with respect to such transfer shall be treated as having been paid on the last day of the taxable year in which the transfer was made."

(3) Deduction for tax in case of taxable terminations.—Paragraph (3) of section 691(c) (relating to deduction for estate tax) is amended to read as follows:

"(3) Special rule for generation-skipping transfers.—In the case of any tax imposed by chapter 13 on a taxable termination or a direct skip occurring as a result of the death of the transferor, there shall be allowed a deduction (under principles similar to the principles of this subsection) for the portion of such tax attributable to items of gross income of the trust which were not properly includible in the gross income of the trust for periods before the date of such termination."

(b) Distributions in Redemption of Stock To Pay Generation-Skipping Transfer Taxes.—Subsection (d) of section 303 is amended to read as follows:

"(d) Special Rules for Generation-Skipping Transfers.—Where stock in a corporation is the subject of a generation-skipping transfer (within the meaning of section 2611(a)) occurring at the same time as and as a result of the death of an individual—

"(1) the stock shall be deemed to be included in the gross estate of such individual;

"(2) taxes of the kind referred to in subsection (a)(1) which are imposed because of the generation-skipping transfer shall be treated as imposed because of such individual's death (and for this purpose the tax imposed by section 2601 shall be treated as an estate tax);

"(3) the period of distribution shall be measured from the date of the generation-skipping transfer; and

"(4) the relationship of stock to the decedent's estate shall be measured with reference solely to the amount of the generation-skipping transfer."

(c) AVAILABILITY OF ALTERNATE VALUATION ELECTION.—

(1) IN GENERAL.—Paragraph (2) of section 2032(c) (relating to election must decrease gross estate and estate tax) is amended to read as follows:

"(2) the sum of the tax imposed by this chapter and the tax imposed by chapter 13 with respect to property includible in the decedent's gross estate (reduced by credits allowable against such taxes)."

(2) CONFORMING AMENDMENT.—Subsection (g) of section 2013 is hereby repealed.

(d) GENERATION-SKIPPING TAX TREATED AS TAXABLE GIFT.—

(1) IN GENERAL.—Subchapter B of chapter 12 is amended by inserting after section 2514 the following new section:

"SEC. 2515. TREATMENT OF GENERATION-SKIPPING TRANSFER TAX.

"In the case of any taxable gift which is a direct skip (within the meaning of chapter 13), the amount of such gift shall be increased by the amount of any tax imposed on the transferor under chapter 13 with respect to such gift."

(2) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 12 is amended by inserting after the item relating to section 2514 the following new item:

"Sec. 2515. Treatment of generation-skipping transfer tax."

(e) EXTENSION OF TIME FOR PAYMENT OF TAX ON CERTAIN DIRECT SKIPS.—Section 6166 is amended by redesignating subsections (i) and (j) as subsections (j) and (k), respectively, and by inserting after subsection (h) the following new subsection:

"(i) SPECIAL RULE FOR CERTAIN DIRECT SKIPS.—To the extent that an interest in a closely held business is the subject of a direct skip (within the meaning of section 2612(c)) occurring at the same time as and as a result of the decedent's death, then for purposes of this section any tax imposed by section 2601 on the transfer of such interest shall be treated as if it were additional tax imposed by section 2001."

SEC. 1433. EFFECTIVE DATES.

(a) GENERAL RULE.—Except as provided in subsection (b), the amendments made by this part shall apply to any generation-skipping transfer (within the meaning of section 2611 of the Internal Revenue Code of 1986) made after the date of the enactment of this Act.

(b) SPECIAL RULES.—

(1) TREATMENT OF CERTAIN INTER VIVOS TRANSFERS MADE AFTER SEPTEMBER 25, 1985.—For purposes of subsection (a) (and chapter 13 of the Internal Revenue Code of 1986 as amended by this part), any inter vivos transfer after September 25, 1985, and on or before the date of the enactment of this Act shall be treated as if it were made on the 1st day after the date of enactment of this Act.

(2) EXCEPTIONS.—The amendments made by this part shall not apply to—

(A) any generation-skipping transfer under a trust which was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985,

(B) any generation-skipping transfer under a will executed before the date of the enactment of this Act if the decedent dies before January 1, 1987, and

(C) any generation-skipping transfer—

(i) under a trust to the extent such trust consists of property included in the gross estate of a decedent (other than property transferred by the decedent during his life after the date of the enactment of this Act), or reinvestments thereof, or

(ii) which is a direct skip which occurs by reason of the death of any decedent;

but only if such decedent was, on the date of the enactment of this Act, under a mental disability to change the disposition of his property and did not regain his competence to dispose of such property before the date of his death.

(3) TREATMENT OF CERTAIN TRANSFERS TO GRANDCHILDREN.—For purposes of chapter 13 of the Internal Revenue Code of 1986, the term "direct skip" shall not include any transfer before January 1, 1990, from a transferor to a grandchild of the transferor to the extent that the aggregate transfers from such transferor to such grandchild do not exceed $2,000,000.

(c) REPEAL OF EXISTING TAX ON GENERATION-SKIPPING TRANSFERS.—

(1) IN GENERAL.—In the case of any tax imposed by chapter 13 of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act), such tax (including interest, additions to tax, and additional amounts) shall not be assessed and if assessed, the assessment shall be abated, and if collected, shall be credited or refunded (with interest) as an overpayment.

(2) WAIVER OF STATUTE OF LIMITATIONS.—If on the date of the enactment of this Act (or at any time within 1 year after such date of enactment) refund or credit of any overpayment of tax resulting from the application of paragraph (1) is barred by any law or rule of law, refund or credit of such overpayment shall, nevertheless, be made or allowed if claim therefore is filed before the date 1 year after the date of the enactment of this Act.

(d) ELECTION FOR CERTAIN TRANSFERS BENEFITING GRANDCHILD.—

(1) IN GENERAL.—For purposes of chapter 13 of the Internal Revenue Code of 1986 (as amended by this Act) and subsection (b) of this section, any transfer in trust for the benefit of a grandchild of a transferor shall be treated as a direct skip if—

(A) the transfer occurs before the date of enactment of this Act,

(B) the transfer would be a direct skip except for the fact that the trust instrument provides that, if the grandchild dies before vesting of the interest transferred, the interest is

transferred to the grandchild's heir (rather than the grandchild's estate), and

(C) an election under this subsection applies to such transfer.

Any transfer treated as a direct skip by reason of the preceding sentence shall be subject to Federal estate tax on the grandchild's death in the same manner as if the contingent gift over had been to the grandchild's estate.

(2) Election.—An election under paragraph (1) shall be made at such time and in such manner as the Secretary of the Treasury or his delegate may prescribe.

TITLE XV—COMPLIANCE AND TAX ADMINISTRATION

Subtitle A—Revision of Certain Penalties, Etc.

SEC. 1501. PENALTY FOR FAILURE TO FILE INFORMATION RETURNS OR STATEMENTS.

(a) General Rule.—Subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end thereof the following new part:

"PART II—FAILURE TO FILE CERTAIN INFORMATION RETURNS OR STATEMENTS

"Sec. 6721. Failure to file certain information returns.
"Sec. 6722. Failure to furnish certain payee statements.
"Sec. 6723. Failure to include correct information.
"Sec. 6724. Waiver; definitions and special rules.

"SEC. 6721. FAILURE TO FILE CERTAIN INFORMATION RETURNS.

"(a) General Rule.—In the case of each failure to file an information return with the Secretary on the date prescribed therefor (determined with regard to any extension of time for filing), the person failing to so file such return shall pay $50 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $100,000.

"(b) Penalty in Case of Intentional Disregard.—If 1 or more failures to which subsection (a) applies are due to intentional disregard of the filing requirement, then, with respect to each such failure—

"(1) the penalty imposed under subsection (a) shall be $100, or, if greater—

"(A) in the case of a return other than a return required under section 6045(a), 6041A(b), 6050H, 6050J, 6050K, or 6050L, 10 percent of the aggregate amount of the items required to be reported, or

"(B) in the case of a return required to be filed by section 6045(a), 6050K, or 6050L, 5 percent of the aggregate amount of the items required to be reported, and

"(2) in the case of any penalty determined under paragraph (1)—

"(A) the $100,000 limitation under subsection (a) shall not apply, and

"(B) such penalty shall not be taken into account in applying the $100,000 limitation to penalties not determined under paragraph (1).

"SEC. 6722. FAILURE TO FURNISH CERTAIN PAYEE STATEMENTS.

"(a) GENERAL RULE.—In the case of each failure to furnish a payee statement on the date prescribed therefor to the person to whom such statement is required to be furnished, the person failing to so furnish such statement shall pay $50 for each such failure, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $100,000.

"(b) FAILURE TO NOTIFY PARTNERSHIP OF EXCHANGE OF PARTNERSHIP INTEREST.—In the case of any person who fails to furnish the notice required by section 6050K(c)(1) on the date prescribed therefor, such person shall pay a penalty of $50 for each such failure.

"SEC. 6723. FAILURE TO INCLUDE CORRECT INFORMATION.

"(a) GENERAL RULE.—If—

"(1) any person files an information return or furnishes a payee statement, and

"(2) such person does not include all of the information required to be shown on such return or statement or includes incorrect information,

such person shall pay $5 for each return or statement with respect to which such failure occurs, but the total amount imposed on such person for all such failures during any calendar year shall not exceed $20,000.

"(b) PENALTY IN CASE OF INTENTIONAL DISREGARD.—If 1 or more failures to which subsection (a) applies are due to intentional disregard of the correct information reporting requirement, then, with respect to each such failure—

"(1) the penalty imposed under subsection (a) shall be $100, or, if greater—

"(A) in the case of a return other than a return required under section 6045(a), 6041A(b), 6050H, 6050J, 6050K, or 6050L, 10 percent of the aggregate amount of the items required to be reported correctly, or

"(B) in the case of a return required to be filed by section 6045(a), 6050K, or 6050L, 5 percent of the aggregate amount of the items required to be reported correctly, and

"(2) in the case of any penalty determined under paragraph (1)—

"(A) the $20,000 limitation under subsection (a) shall not apply, and

"(B) such penalty shall not be taken into account in applying the $20,000 limitation to penalties not determined under paragraph (1).

"(c) COORDINATION WITH SECTION 6676.—No penalty shall be imposed under subsection (a) or (b) with respect to any return or statement if a penalty is imposed under section 6676 (relating to failure to supply identifying number) with respect to such return or statement.

"SEC. 6724. WAIVER; DEFINITIONS AND SPECIAL RULES.

"(a) REASONABLE CAUSE WAIVER.—No penalty shall be imposed under this part with respect to any failure if it is shown that such failure is due to reasonable cause and not to willful neglect.

"(b) PAYMENT OF PENALTY.—Any penalty imposed by this part shall be paid on notice and demand by the Secretary and in the same manner as tax.

"(c) SPECIAL RULES FOR FAILURE TO FILE INTEREST AND DIVIDEND RETURNS OR STATEMENTS.—

"(1) HIGHER STANDARDS FOR WAIVER.—In the case of any interest or dividend return or statement—

"(A) subsection (a) shall not apply, but

"(B) no penalty shall be imposed under this part if it is shown that the person otherwise liable for such penalty exercised due diligence in attempting to satisfy the requirement with respect to such return or statement.

"(2) LIMITATIONS NOT TO APPLY.—In the case of any interest or dividend return or statement—

"(A) the $100,000 limitations of sections 6721(a) and 6722(a) and the $20,000 limitation of section 6723(a) shall not apply (and any penalty imposed on any failure involving such a return or statement shall not be taken into account in applying such limitations to other penalties), and

"(B) penalties imposed with respect to such returns or statements shall not be taken into account for purposes of applying such limitations with respect to other returns or statements.

"(3) SELF ASSESSMENT.—Any penalty imposed under this part on any person with respect to an interest or dividend return or statement—

"(A) shall be assessed and collected in the same manner as an excise tax imposed by subtitle D, and

"(B) shall be due and payable on April 1 of the calendar year following the calendar year for which such return or statement is required.

"(4) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed under this part with respect to an interest or dividend return or statement.

"(5) INTEREST OR DIVIDEND RETURN OR STATEMENT.—For purposes of this subsection, the term 'interest or dividend return or statement' means—

"(A) any return required by section 6042(a)(1), 6044(a)(1), or 6049(a), and

"(B) any statement required under section 6042(c), 6044(e), or 6049(c).

"(d) DEFINITIONS.—For purposes of this part—

"(1) INFORMATION RETURN.—The term 'information return' means—

"(A) any statement of the amount of payments to another person required by—

"(i) section 6041 (a) or (b) (relating to certain information at source),

"(ii) section 6042(a)(1) (relating to payments of dividends),

"(iii) section 6044(a)(1) (relating to payments of patroncge dividends),

"(iv) section 6049(a) (relating to payments of interest),

"(v) section 6050A(a) (relating to reporting requirements of certain fishing boat operators),

"(vi) section 6050N(a) (relating to payments of royalties), or

"(vii) section 6051(d) (relating to information returns with respect to income tax withheld), and

"(B) any return required by—

"(i) section 4997(a) (relating to information with respect to windfall profit tax on crude oil),

"(ii) section 6041A (a) or (b) (relating to returns of direct sellers),

"(iii) section 6045 (a) or (d) (relating to returns of brokers),

"(iv) section 6050H(a) (relating to mortgage interest received in trade or business from individuals),

"(v) section 6050I(a) (relating to cash received in trade or business),

"(vi) section 6050J(a) (relating to foreclosures and abandonments of security),

"(vii) section 6050K(a) (relating to exchanges of certain partnership interests),

"(viii) section 6050L(a) (relating to returns relating to certain dispositions of donated property),

"(ix) section 6052(a) (relating to reporting payment of wages in the form of group-term life insurance), or

"(x) section 6053(c)(1) (relating to reporting with respect to certain tips).

"(2) Payee statement.—The term 'payee statement' means any statement required to be furnished under—

"(A) section 4997(a) (relating to records and information; regulations),

"(B) section 6031(b), 6034A, or 6037(b) (relating to statements furnished by certain pass-thru entities),

"(C) section 6039(a) (relating to information required in connection with certain options),

"(D) section 6041(d) (relating to information at source),

"(E) section 6041A(e) (relating to returns regarding payments of remuneration for services and direct sales),

"(F) section 6042(c) (relating to returns regarding payments of dividends and corporate earnings and profits),

"(G) section 6044(e) (relating to returns regarding payments of patronage dividends),

"(H) section 6045 (b) or (d) (relating to returns of brokers),

"(I) section 6049(c) (relating to returns regarding payments of interest),

"(J) section 6050A(b) (relating to reporting requirements of certain fishing boat operators),

"(K) section 6050C (relating to information regarding windfall profit tax on domestic crude oil),

"(L) section 6050H(d) (relating to returns relating to mortgage interest received in trade or business from individuals),

"(M) section 6050I(e) (relating to returns relating to cash received in trade or business),

"(N) section 6050J(e) (relating to returns relating to foreclosures and abandonments of security),

"(O) section 6050K(b) (relating to returns relating to exchanges of certain partnership interests),

"(P) section 6050L(c) (relating to returns relating to certain dispositions of donated property),

"(Q) section 6050N(b) (relating to returns regarding payments of royalties),

"(R) section 6051 (relating to receipts for employees),

"(S) section 6052(b) (relating to returns regarding payment of wages in the form of group-term life insurance), or

"(T) section 6053 (b) or (c) (relating to reports of tips)."

(b) INCREASE IN MAXIMUM PENALTY FOR FAILURE TO SUPPLY IDENTIFYING NUMBERS.—Subsection (a) of section 6676 (relating to failure to supply identifying numbers) is amended by striking out "$50,000" and inserting in lieu thereof "$100,000".

(c) CLARIFICATION OF PENALTY FOR FAILURE TO FURNISH PAYEE STATEMENTS.—

(1) Subsection (d) of section 6041 is amended to read as follows:

"(d) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each person with respect to whom such a return is required a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made. To the extent provided in regulations prescribed by the Secretary, this subsection shall also apply to persons required to make returns under subsection (b)."

(2) Subsection (c) of section 6042 is amended to read as follows:

"(c) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished (either in person or in a statement mailing by first-class mail which includes adequate notice that the statement is en-

closed) to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made and shall be in such form as the Secretary may prescribe by regulations."

(3) Subsection (e) of section 6044 is amended to read as follows:

"(e) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every cooperative required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the cooperative required to make such return, and

"(2) the aggregate amount of payments to the person required to be shown on the return.

The written statement required under the preceding sentence shall be furnished (either in person or in a statement mailing by first-class mail which includes adequate notice that the statement is enclosed) to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made and shall be in such form as the Secretary may prescribe by regulations."

(4) Subsection (b) of section 6045 is amended to read as follows:

"(b) STATEMENTS TO BE FURNISHED TO CUSTOMERS.—Every person required to make a return under subsection (a) shall furnish to each customer whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the information required to be shown on such return with respect to such customer.

The written statement required under the preceding sentence shall be furnished to the customer on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(5) Subsection (c) of section 6049 is amended to read as follows:

"(c) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—

"(1) IN GENERAL.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(A) the name and address of the person required to make such return, and

"(B) the aggregate amount of payments to, or the aggregate amount includible in the gross income of, the person required to be shown on the return.

"(2) TIME AND FORM OF STATEMENT.—The written statement under paragraph (1)—

"(A) shall be furnished (either in person or in a statement mailing by first-class mail which includes adequate notice that the statement is enclosed) to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made, and

"(B) shall be in such form as the Secretary may prescribe by regulations."

(6) Subsection (b) of section 6050A is amended to read as follows:

"(b) WRITTEN STATEMENT.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing the information relating to such person required to be contained in such return. The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(7) Subsection (b) of section 6050B is amended to read as follows:

"(b) STATEMENTS TO BE FURNISHED TO INDIVIDUALS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of payments to the individual required to be shown on such return.

The written statement required under the preceding sentence shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(8) Subsection (b) of section 6050E is amended to read as follows:

"(b) STATEMENTS TO BE FURNISHED TO INDIVIDUALS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return a written statement showing—

"(1) the name of the State or political subdivision thereof, and

"(2) the information required to be shown on the return with respect to refunds, credits, and offsets to the individual.

The written statement required under the preceding sentence shall be furnished to the individual during January of the calendar year following the calendar year for which the return under subsection (a) was required to be made. No statement shall be required under this subsection with respect to any individual if it is determined (in the manner provided by regulations) that such individual did not claim itemized deductions under chapter 1 for the taxable year giving rise to the refund, credit, or offset."

(9) Subsection (b) of section 6050F is amended to read as follows:

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual *whose name is required to be set forth in such return a written statement showing—*

"(1) the name of the agency making the payments, and

"(2) the aggregate amount of payments, of repayments, and of reductions, with respect to the individual required to be shown on such return.

The written statement required under the preceding sentence shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(10) Subsection (b) of section 6050G is amended to read as follows:

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—The Railroad Retirement Board shall furnish to each individual whose name is required to be set forth in the return under subsection (a) a written statement showing—

"(1) the aggregate amount of payments to such individual, and of employee contributions with respect thereto, required to be shown on the return, and

"(2) such other information as the Secretary may require.

The written statement required under the preceding sentence shall be furnished to the individual on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(11) Subsection (d) of section 6050H is amended to read as follows:

"(d) STATEMENTS TO BE FURNISHED TO INDIVIDUALS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each individual whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of interest described in subsection (a)(2) received by the person required to make such return from the individual to whom the statement is required to be furnished.

The written statement required under the preceding sentence shall be furnished on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(12) Subsection (e) of section 6050I is amended to read as follows:

"(e) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS REQUIRED.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of cash described in subsection (a) received by the person required to make such return.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(13) Subsection (b) of section 6050K is amended to read as follows:

"(b) Statements To Be Furnished to Transferor and Transferee.—Every partnership required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the partnership required to make such return, and

"(2) the information required to be shown on the return with respect to such person.

The written statement required under the preceding sentence shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(14) Subsection (b) of section 6052 is amended to read as follows:

"(b) Statements To Be Furnished to Employees With Respect to Whom Information Is Required.—Every employer required to make a return under subsection (a) shall furnish to each employee whose name is required to be set forth in such return a written statement showing the cost of the group-term life insurance shown on such return. The written statement required under the preceding sentence shall be furnished to the employee on or before January 31 of the year following the calendar year for which the return under subsection (a) was required to be made."

(15) Subsection (a) of section 6034A is amended—

(A) by striking out "making the return required to be filed" and inserting in lieu thereof "required to file a return",

(B) by striking out "was filed" and inserting in lieu thereof "was required to be filed", and

(C) by striking out "shown on such return" and inserting in lieu thereof "required to be shown on such return".

(16) Subsection (b) of section 6031 (relating to return of partnership income) is amended—

(A) by striking out "was filed" and inserting in lieu thereof "was required to be filed", and

(B) by striking out "shown on such return" and inserting in lieu thereof "required to be shown on such return".

(d) Conforming Amendments.—

(1)(A) Section 6652 is amended—

(i) by striking out subsection (a) and by redesignating subsections (b) through (k) as subsections (a) through (j), respectively, and

(ii) by striking out "Other Returns" in the heading of subsection (a) (as so redesignated) and inserting in lieu thereof "Returns With Respect to Certain Payments Aggregating Less Than $10".

(B) Subsection (g) of section 219 is amended by striking out "section 6652(h)" and inserting in lieu thereof "section 6652(g)".

(C) Sections 6033(e), 6034(c), and 6043(c) are each amended by striking out "section 6652(d)" and inserting in lieu thereof "section 6652(c)".

(D) Section 6047(e)(1) and 6058(f) are each amended by striking out "section 6652(f)" and inserting in lieu thereof "section 6652(e)".

(E) Paragraph (1) of section 6050C(d) is amended by striking out "section 6652(b)" and inserting in lieu thereof "section 6722".

(F) Subsection (g) of section 6057 is amended by striking out "section 6652(e)" and inserting in lieu thereof "section 6652(d)".

(2) Section 6678 is hereby repealed.

(3) Subchapter B of chapter 68 is amended by inserting after the subchapter heading the following:

"Part I. General provisions.
"Part II. Failure to file certain information returns or statements.

"PART I—GENERAL PROVISIONS".

(4) The table of sections for subchapter B of chapter 68 (as in effect before the amendment made by paragraph (3)) is amended by striking out the item relating to section 6678.

(e) Effective Date.—The amendments made by this section shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1986, except that the amendments made by subsections (c)(2), (c)(3), and (c)(5) shall apply to returns the due for which (determined without regard to extensions) is after the date of the enactment of this Act.

SEC. 1502. INCREASE IN PENALTY FOR FAILURE TO PAY TAX.

(a) General Rule.—Section 6651 (relating to failure to file tax return or to pay tax) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) Increase in Penalty for Failure To Pay Tax in Certain Cases.—

"(1) In general.—In the case of each month (or fraction thereof) beginning after the day described in paragraph (2) of this subsection, paragraphs (2) and (3) of subsection (a) shall be applied by substituting '1 percent' for '0.5 percent' each place it appears.

"(2) Description.—For purposes of paragraph (1), the day described in this paragraph is the earlier of—

"(A) the day 10 days after the date on which notice is given under section 6331(d), or

"(B) the day on which notice and demand for immediate payment is given under the last sentence of section 6331(a)."

(b) Repeal of Certain Reduction in Failure To Pay Penalty.—Paragraph (1) of section 6651(c) is amended to read as follows:

"(1) Additions under more than one paragraph.—With respect to any return, the amount of the addition under paragraph (1) of subsection (a) shall be reduced by the amount of the addition under paragraph (2) of subsection (a) for any month (or fraction thereof) to which an addition to tax applies under both paragraphs (1) and (2). In any case described in the last

sentence of subsection (a), the amount of the addition under paragraph (1) of subsection (a) shall not be reduced under the preceding sentence below the amount provided in such last sentence."

(c) Effective Dates.—

(1) Subsection (a).—The amendments made by subsection (a) shall apply—

(A) to failures to pay which begin after December 31, 1986, and

(B) to failures to pay which begin on or before December 31, 1986, if after December 31, 1986—

(i) notice (or renotice) under section 6331(d) of the Internal Revenue Code of 1954 is given with respect to such failure, or

(ii) notice and demand for immediate payment of the underpayment is made under the last sentence of section 6331(a) of such Code.

In the case of a failure to pay described in subparagraph (B), paragraph (2) of section 6651(d) of such Code (as added by subsection (a)) shall be applied by taking into account the first notice (or renotice) after December 31, 1986.

(2) Subsection (b).—The amendment made by subsection (b) shall apply to amounts assessed after December 31, 1986, with respect to failures to pay which begin before, on, or after such date.

SEC. 1503. AMENDMENTS TO PENALTY FOR NEGLIGENCE AND FRAUD.

(a) General Rule.—Section 6653 (relating to failure to pay tax) is amended by striking out subsections (a) and (b) and inserting in lieu thereof the following:

"(a) Negligence.—

"(1) In general.—If any part of any underpayment (as defined in subsection (c)) is due to negligence or disregard of rules or regulations, there shall be added to the tax an amount equal to the sum of—

"(A) 5 percent of the underpayment, and

"(B) an amount equal to 50 percent of the interest payable under section 6601 with respect to the portion of such underpayment which is attributable to negligence for the period beginning on the last date prescribed by law for payment of such underpayment (determined without regard to any extension) and ending on the date of the assessment of the tax (or, if earlier, the date of the payment of the tax).

"(2) Underpayment taken into account reduced by portion attributable to fraud.—There shall not be taken into account under this subsection any portion of an underpayment attributable to fraud with respect to which a penalty is imposed under subsection (b).

"(3) Negligence.—For purposes of this subsection, the term 'negligence' includes any failure to make a reasonable attempt to comply with the provisions of this title, and the term 'disregard' includes any careless, reckless, or intentional disregard.

"(b) Fraud.—

"(1) In general.—If any part of any underpayment (as defined in subsection (c)) of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to the sum of—

"(A) 75 percent of the portion of the underpayment which is attributable to fraud, and

"(B) an amount equal to 50 percent of the interest payable under section 6601 with respect to such portion for the period beginning on the last day prescribed by law for payment of such underpayment (determined without regard to any extension) and ending on the date of the assessment of the tax or, if earlier, the date of the payment of the tax.

"(2) Determination of portion attributable to fraud.—If the Secretary establishes that any portion of an underpayment is attributable to fraud, the entire underpayment shall be treated as attributable to fraud, except with respect to any portion of the underpayment which the taxpayer establishes is not attributable to fraud.

"(3) Special rule for joint returns.—In the case of a joint return, this subsection shall not apply with respect to a spouse unless some part of the underpayment is due to the fraud of such spouse."

(b) Special Rule for Interest or Dividend Payments Extended to Other Amounts Shown on Information Returns.—Subsection (g) of section 6653 (relating to special rule in the case of interest or dividend payments) is amended to read as follows:

"(g) Special Rule for Amounts Shown on Information Returns.—If—

"(1) any amount is shown on—

"(A) an information return (as defined in section 6724(d)(1)), or

"(B) a return filed under section 6031, section 6037, section 6012(a) by an estate or trust, section 6050B, or section 6050E, and

"(2) the payee (or other person with respect to whom the return is made) fails to properly show such amount on his return,

any portion of an underpayment attributable to such failure shall be treated, for purposes of subsection (a), as due to negligence in the absence of clear and convincing evidence to the contrary."

(c) Conforming Amendments.—

(1) Subsection (d) of section 6222 is amended by striking out "intentional or negligent".

(2) Subsection (d) of section 6653 is amended by striking out "same underpayment" and inserting in lieu thereof "portion of the underpayment which is attributable to fraud".

(3) Subsection (f) of section 6653 is amended by striking out "or intentional disregard of rules and regulations (but without intent to defraud)".

(d) Change in Section Heading.—

(1) The heading for section 6653 (relating to failure to pay tax) is amended to read as follows:

"SEC. 6653. ADDITIONS TO TAX FOR NEGLIGENCE AND FRAUD."

(2) The item relating to section 6653 in the table of sections for subpart A of chapter 68 is amended to read as follows:

"Sec. 6653. Additions to tax for negligence and fraud."

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1986.

SEC. 1504. INCREASE IN PENALTY FOR SUBSTANTIAL UNDERSTATEMENT OF LIABILITY.

(a) IN GENERAL.—Subsection (a) of section 6661 (relating to substantial understatement of liability) is amended by striking out "10 percent" and inserting in lieu thereof "20 percent".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1986.

Subtitle B—Interest Provisions

SEC. 1511. DIFFERENTIAL INTEREST RATE.

(a) GENERAL RULE.—Section 6621 (relating to determination of rate of interest) is amended by striking out subsections (a), (b), and (c) and inserting in lieu thereof the following:

"(a) GENERAL RULE.—

"(1) OVERPAYMENT RATE.—The overpayment rate established under this section shall be the sum of—

"(A) the short-term Federal rate determined under subsection (b), plus

"(B) 2 percentage points.

"(2) UNDERPAYMENT RATE.—The underpayment rate established under this section shall be the sum of—

"(A) the short-term Federal rate determined under subsection (b), plus

"(B) 3 percentage points.

"(b) SHORT-TERM FEDERAL RATE.—For purposes of this section—

"(1) GENERAL RULE.—The Secretary shall determine the short-term Federal rate for the first month in each calendar quarter.

"(2) PERIOD DURING WHICH RATE APPLIES.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), the Federal short-term rate determined under paragraph (1) for any month shall apply during the first calendar quarter beginning after such month.

"(B) SPECIAL RULE FOR INDIVIDUAL ESTIMATED TAX.—In determining the addition to tax under section 6654 for failure to pay estimated tax for any taxable year, the Federal short-term rate which applies during the 3rd month following such taxable year shall also apply during the first 15 days of the 4th month following such taxable year.

"(3) FEDERAL SHORT-TERM RATE.—The Federal short-term rate for any month shall be the Federal short-term rate determined during such month by the Secretary in accordance with section 1274(d). Any such rate shall be rounded to the nearest full per-

cent (or, if a multiple of ½ of 1 percent, such rate shall be increased to the next highest full percent)."

(b) COORDINATION BY REGULATION.—The Secretary of the Treasury or his delegate may issue regulations to coordinate section 6621 of the Internal Revenue Code of 1954 (as amended by this section) with section 6601(f) of such Code. Such regulations shall not apply to any period after the date 3 years after the date of the enactment of this Act.

(c) TECHNICAL AMENDMENTS.—

(1) Section 6621 is amended—

(A) by redesignating subsection (d) as subsection (c), and

(B) by striking out "the adjusted rate established under subsection (b)" in subsection (c)(1) (as so redesignated) and inserting in lieu thereof "the underpayment rate established under this section", and

(C) by striking out "annual" in subsecton (c)(1) (as so redesignated).

(2) Subparagraph (G) of section 47(d)(3) is amended by striking out "determined under section 6621" and inserting in lieu thereof "determined at the underpayment rate established under section 6621".

(3) The last sentence of section 48(d)(6)(C)(ii) (defining at risk percentage) is amended by striking out "the rate" and inserting in lieu thereof "the underpayment rate".

(4) Subparagraph (B) of section 167(q)(2) is amended by striking out "at the rate determined under section 6621" and inserting in lieu thereof "at the underpayment rate established under section 6621".

(5) Subparagraph (B) of section 644(a)(2) is amended by striking out "the annual rate established under section 6621" and inserting in lieu thereof "the underpayment rate established under section 6621".

(6) Subparagraph (A) of section 852(e)(3) is amended by striking out "the annual rate established under section 6621" and inserting in lieu thereof "the underpayment rate established under section 6621".

(7) Paragraph (2) of section 4497(c) is amended by striking out "at rates determined under section 6621" and inserting in lieu thereof "at the underpayment rate established under section 6621".

(8) Subsection (e) of section 6214 is amended by striking out "section 6621(d)(4)" and inserting in lieu thereof "section 6621(c)(4)".

(9) Paragraph (1) of section 6332(c) is amended by striking out "an annual rate established under section 6621" and inserting in lieu thereof "the underpayment rate established under section 6621".

(10) Subsection (c) of section 6343 is amended by striking out "an annual rate established under section 6621" and inserting in lieu thereof "the overpayment rate established under section 6621".

(11) Subsection (a) of section 6601 is amended by striking out "an annual rate established under section 6621" and inserting

in lieu thereof "the underpayment rate established under section 6621".

(12) Section 6602 is amended by striking out "an annual rate established under section 6621" and inserting in lieu thereof "the underpayment rate established under section 6621".

(13) Subsection (a) of section 6611 is amended by striking out "an annual rate established under section 6621" and inserting in lieu thereof "the overpayment rate established under section 6621".

(14) Paragraph (1) of section 6654(a) is amended by striking out "the applicable annual rate established under section 6621" and inserting in lieu thereof "the underpayment rate established under section 6621".

(15) Paragraph (1) of section 6655(a) is amended by striking out "the rate established under section 6621" and inserting in lieu thereof "the underpayment rate established under section 6621".

(16) Subsection (g) of section 7426 is amended by striking out "an annual rate established under section 6621" and inserting in lieu thereof "the overpayment rate established under section 6621".

(17) Section 1961(c)(1) of title 28, United States Code, is amended by striking out "a rate established under section 6621" and inserting in lieu thereof "the underpayment rate or overpayment rate (whichever is appropriate) established under section 6621".

(18) Section 2411 of title 28, United States Code, is amended by striking out "an annual rate established under section 6621" and inserting in lieu thereof "the overpayment rate established under section 6621".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply for purposes of determining interest for periods after December 31, 1986.

SEC. 1512. INTEREST ON ACCUMULATED EARNINGS TAX TO ACCRUE BEGINNING ON DATE RETURN IS DUE.

(a) IN GENERAL.—Subsection (b) of section 6601 (relating to last date prescribed for payment) is amended by redesignating paragraph (4) as paragraph (5) and by inserting after paragraph (3) the following new paragraph:

> *"(4) ACCUMULATED EARNINGS TAX.—In the case of the tax imposed by section 531 for any taxable year, the last date prescribed for payment shall be deemed to be the due date (without regard to extensions) for the return of tax imposed by subtitle A for such taxable year."*

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1985.

Subtitle C—Information Reporting Provisions

SEC. 1521. REQUIREMENT OF REPORTING FOR REAL ESTATE TRANSACTIONS.

(a) GENERAL RULE.—Section 6045 (relating to returns of brokers) is amended by adding at the end thereof the following new subsection:

"(e) RETURN REQUIRED IN THE CASE OF REAL ESTATE TRANSACTIONS.—

"(1) IN GENERAL.—In the case of a real estate transaction, the real estate broker shall file a return under subsection (a) and a statement under subsection (b) with respect to such transaction.

"(2) REAL ESTATE BROKER.—For purposes of this subsection, the term 'real estate broker' means any of the following persons involved in a real estate transaction in the following order:

"(A) the person (including any attorney or title company) responsible for closing the transaction,

"(B) the mortgage lender,

"(C) the seller's broker,

"(D) the buyer's broker, or

"(E) such other person designated in regulations prescribed by the Secretary.

Any person treated as a real estate broker under the preceding sentence shall be treated as a broker for purposes of subsection (c)(1)."

(b) BACKUP WITHHOLDING REQUIREMENTS.—Paragraph (5) of section 3406(h) (relating to other definitions and special rules) is amended by adding at the end thereof the following new subparagraph:

"(D) REAL ESTATE BROKER NOT TREATED AS A BROKER.—Except as provided by regulations, such term shall not include any real estate broker (as defined in section 6045(e)(2))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to real estate transactions closing after December 31, 1986.

SEC. 1522. INFORMATION REPORTING ON PERSONS RECEIVING CONTRACTS FROM CERTAIN FEDERAL AGENCIES.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050M. RETURNS RELATING TO PERSONS RECEIVING CONTRACTS FROM FEDERAL EXECUTIVE AGENCIES.

"(a) REQUIREMENT OF REPORTING.—The head of every Federal executive agency which enters into any contract shall make a return (at such time and in such form as the Secretary may by regulations prescribe) setting forth—

"(1) the name, address, and TIN of each person with which such agency entered into a contract during the calendar year, and

"(2) such other information as the Secretary may require.

"(b) FEDERAL EXECUTIVE AGENCY.—For purposes of this section, the term 'Federal executive agency' means—

"(1) any Executive agency (as defined in section 105 of title 5, United States Code) other than the General Accounting Office,

"(2) any military department (as defined in section 102 of such title), and

"(3) the United States Postal Service and the Postal Rate Commission.

"(c) AUTHORITY TO EXTEND REPORTING TO LICENSES AND SUBCONTRACTS.—To the extent provided in regulations, this section also shall apply to—

"(1) licenses granted by Federal executive agencies, and

"(2) subcontracts under contracts to which subsection (a) applies.

"(d) AUTHORITY TO PRESCRIBE MINIMUM AMOUNTS.—This section shall not apply to contracts or licenses in any class which are below a minimum amount or value which may be prescribed by the Secretary by regulations for such class."

(b) CLERICAL AMENDMENT.—The table of sections for such subpart B is amended by adding at the end thereof the following new item:

"Sec. 6050M. Returns relating to persons receiving contracts from Federal executive agencies."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts (and subcontracts) entered into, and licenses granted, before, on, or after January 1, 1987.

SEC. 1523. RETURNS REGARDING PAYMENTS OF ROYALTIES.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050N. RETURNS REGARDING PAYMENTS OF ROYALTIES.

"(a) REQUIREMENT OF REPORTING.—Every person—

"(1) who makes payments of royalties (or similar amounts) aggregating $10 or more to any other person during any calendar year, or

"(2) who receives payments of royalties (or similar amounts) as a nominee and who makes payments aggregating $10 or more during any calendar year to any other person with respect to the royalties (or similar amounts) so received,

shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the person to whom paid.

"(b) STATEMENTS TO BE FURNISHED TO PERSONS WITH RESPECT TO WHOM INFORMATION IS FURNISHED.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return a written statement showing—

"(1) the name and address of the person required to make such return, and

"(2) the aggregate amount of payments to the person required to be shown on such return.

The written statement required under the preceding sentence shall be furnished (either in person or in a statement mailing by first-class mail which includes adequate notice that the statement is en-

closed) to the person on or before January 31 of the year following the calendar year for which the return under subsection (a) was made and shall be in such form as the Secretary may prescribe by regulations.

"(c) EXCEPTION FOR PAYMENTS TO CERTAIN PERSONS.—Except to the extent otherwise provided in regulations, this section shall not apply to any amount paid to a person described in subparagraph (A), (B), (C), (D), (E), or (F) of section 6049(b)(4)."

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (3) of section 3406(b) (relating to backup withholding) is amended—

(A) by striking out "or" at the end of subparagraph (C),

(B) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof ", or", and

(C) by adding at the end thereof the following new subparagraph:

"(E) section 6050N (relating to payments of royalties)."

(2) Subsection (a) of section 6041 (relating to information at source) is amended by striking out "or 6049(a)" and inserting in lieu thereof "6049(a), or 6050N(a)".

(3) Section 6676 (relating to failure to supply identifying numbers) is amended—

(A) by striking out "or 6049" in subsection (a)(3) and inserting in lieu thereof "6049, or 6050N",

(B) by striking out "or 6049" in subsection (b)(1)(A) and inserting in lieu thereof "6049, or 6050N", and

(C) by striking out "AND DIVIDEND" in the heading for subsection (b) and inserting in lieu thereof ", DIVIDENDS, AND ROYALTIES".

(c) CLERICAL AMENDMENT.—The table of sections of subpart B of part III of subchapter A of chapter 61 is amended by adding at the end thereof the following new item:

"Sec. 6050N. Returns regarding payments of royalties."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to payments made after December 31, 1986.

SEC. 1524. TINS REQUIRED FOR DEPENDENTS CLAIMED ON TAX RETURNS.

(a) GENERAL RULE.—Section 6109 (relating to identifying numbers) is amended by adding at the end thereof the following new subsection:

"(e) FURNISHING NUMBER FOR CERTAIN DEPENDENTS.—If—

"(1) any taxpayer claims an exemption under section 151 for any dependent on a return for any taxable year, and

"(2) such dependent has attained the age of 5 years before the close of such taxable year,

such taxpayer shall include on such return the identifying number (for purposes of this title) of such dependent."

(b) PENALTY FOR FAILURE TO SUPPLY TIN.—Section 6676 (relating to failure to supply identifying numbers) is amended by adding at the end thereof the following new subsection:

"(e) PENALTY FOR FAILURE TO SUPPLY TIN OF DEPENDENT.—

"(1) IN GENERAL.—If any person required under section 6109(e) to include the TIN of any dependent on his return fails to include such number on such return (or includes an incorrect

number), such person shall, unless it is shown that such failure is due to reasonable cause and not willful neglect, pay a penalty of $5 for each such failure.

"(2) SUBSECTION (a) NOT TO APPLY.—Subsection (a) shall not apply to any failure described in paragraph (1) of this subsection."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to returns the due date for which (determined without regard to extensions) is after December 31, 1987.

SEC. 1525. TAX-EXEMPT INTEREST REQUIRED TO BE SHOWN ON RETURN.

(a) IN GENERAL.—Section 6012 (relating to persons required to make returns of income) is amended by redesignating subsection (d) as subsection (e) by inserting after subsection (c) the following new subsection:

"(d) TAX-EXEMPT INTEREST REQUIRED TO BE SHOWN ON RETURN.—Every person required to file a return under this section for the taxable year shall include on such return the amount of interest received or accrued during the taxable year which is exempt from the tax imposed by chapter 1."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

Subtitle D—Provisions Relating to Tax Shelters

SEC. 1531. MODIFICATION OF TAX SHELTER RATIO TEST FOR REGISTRATION OF TAX SHELTERS.

(a) IN GENERAL.—Subparagraph (A) of section 6111(c)(2) (defining tax shelter ratio) is amended by striking out "200 percent" and inserting in lieu thereof "350 percent".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to any tax shelter (within the meaning of section 6111 of the Internal Revenue Code of 1986 as amended by this section) interests in which are first offered for sale after December 31, 1986 take effect on January 1, 1987.

SEC. 1532. INCREASED PENALTY FOR FAILURE TO REGISTER TAX SHELTERS.

(a) IN GENERAL.—Paragraph (2) of section 6707(a) (relating to penalty for failure to register tax shelters) is amended to read as follows:

"(2) AMOUNT OF PENALTY.—The penalty imposed under paragraph (1) with respect to any tax shelter shall be an amount equal to the greater of—

"(A) 1 percent of the aggregate amount invested in such tax shelter, or

"(B) $500."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to failures with respect to tax shelters interests in which are first offered for sale after the date of the enactment of this Act.

SEC. 1533. PENALTY FOR FAILURE TO INCLUDE TAX SHELTER IDENTIFICATION NUMBER ON RETURN INCREASED TO $250.

(a) In General.—Paragraph (2) of section 6707(b) (relating to penalty for failure to furnish tax shelter identification number) is amended by striking out "$50" and inserting in lieu thereof "$250".

(b) Effective Date.—The amendment made by this section shall apply to returns filed after the date of the enactment of this Act.

SEC. 1534. INCREASED PENALTY FOR FAILURE TO MAINTAIN LISTS OF INVESTORS IN POTENTIALLY ABUSIVE TAX SHELTERS.

(a) In General.—Subsection (a) of section 6708 (relating to failure to maintain lists of investors in potentially abusive tax shelters) is amended by striking out "$50,000" and inserting in lieu thereof "$100,000".

(b) Effective Date.—The amendments made by this section shall apply to failures occurring or continuing after the date of the enactment of this Act.

SEC. 1535. CLARIFICATION OF TREATMENT OF SHAM OR FRAUDULENT TRANSACTIONS UNDER SECTION 6621(c).

(a) Clarification of Treatment of Sham or Fraudulent Transactions.—Subparagraph (A) of section 6621(c)(3) (as so redesignated) is amended by striking out "and" at the end of clause (iii), by striking out the period at the end of clause (iv) and inserting in lieu thereof ", and", and by adding at the end thereof the following new clause:

"(v) any sham or fraudulent transaction."

(b) Effective Date.—The amendment made by subsection (a) shall apply to interest accruing after December 31, 1984; except that such amendment shall not apply in the case of any underpayment with respect to which there was a final court decision before the date of the enactment of this Act.

Subtitle E—Estimated Tax Provisions

SEC. 1541. CURRENT YEAR LIABILITY TEST INCREASED FROM 80 TO 90 PERCENT FOR ESTIMATED TAX PAYMENTS BY INDIVIDUALS.

(a) In General.—Clause (i) of section 6654(d)(1)(B) (defining required annual payment) is amended by striking out "80 percent" each place it appears and inserting in lieu thereof "90 percent".

(b) Technical Amendments.—

(1) The table contained in clause (ii) of section 6654(d)(2)(C) (defining applicable percentage) is amended—

(A) by striking out "20" and inserting in lieu thereof "22.5",

(B) by striking out "40" and inserting in lieu thereof "45",

(C) by striking out "60" and inserting in lieu thereof "67.5", and

(D) by striking out "80" and inserting in lieu thereof "90".

(2) Subparagraph (C) of section 6654(i)(1) (relating to special rules for farmers and fishermen) is amended by striking out "80 percent" and inserting in lieu thereof "90 percent".

(3) The table contained in subparagraph (B) of section 6654(j)(3) (relating to special rules for nonresident aliens) is amended—

(A) by striking out "40" and inserting in lieu thereof "45",

(B) by striking out "60" and inserting in lieu thereof "67.5", and

(C) by striking out "80" and inserting in lieu thereof "90".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1542. CERTAIN TAX-EXEMPT ORGANIZATIONS SUBJECT TO CORPORATE ESTIMATED TAX RULES.

(a) GENERAL RULE.—Section 6154 (relating to installment payments of estimated income tax by corporations) is amended by adding at the end thereof the following new subsection:

"(h) CERTAIN TAX-EXEMPT ORGANIZATIONS.—For purposes of this section and section 6655—

"(1) any organization subject to the tax imposed by section 511, and any private foundation subject to the tax imposed by section 4940, shall be treated as a corporation subject to tax under section 11,

"(2) any tax imposed by section 511 or 4940 shall be treated as a tax imposed by section 11, and

"(3) any reference to taxable income shall be treated as including a reference to unrelated business taxable income or net investment income (as the case may be)."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1986.

SEC. 1543. WAIVER OF ESTIMATED PENALTIES FOR 1986 UNDERPAYMENTS ATTRIBUTABLE TO THIS ACT.

No addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1986 (relating to failure to pay estimated tax) for any period before April 16, 1987 (March 16, 1987, in the case of a taxpayer subject to section 6655 of such Code), with respect to any underpayment, to the extent such underpayment was created or increased by any provision of this Act.

Subtitle F—Provisions Regarding Judicial Proceedings

SEC. 1551. LIMITATIONS ON AWARDING OF COURT COSTS AND CERTAIN FEES MODIFIED.

(a) MAXIMUM DOLLAR LIMITATION REMOVED.—Subsection (b) of section 7430 (relating to awarding of court costs and certain fees) is amended by striking out paragraph (1) and redesignating paragraphs (2), (3), and (4) as paragraphs (1), (2), and (3), respectively.

(b) AWARDING OF COURT COSTS AND CERTAIN FEES DENIED IF PREVAILING PARTY PROTRACTS PROCEEDINGS.—Section 7430(b) (relating to limitations to awarding of court costs and certain fees) is amended by adding at the end thereof the following new paragraph:

"(4) COSTS DENIED WHERE PARTY PREVAILING PROTRACTS PROCEEDINGS.—No award for reasonable litigation costs may be made under subsection (a) with respect to any portion of the civil proceeding during which the prevailing party has unreasonably protracted such proceeding."

(c) ADDITIONAL LIMITATIONS ON FEES OF EXPERT WITNESSES AND ATTORNEYS.—Subparagraph (A) of section 7430(c)(1) (defining reasonable litigation costs) is amended to read as follows:

"(A) IN GENERAL.—The term 'reasonable litigation costs' includes—

"(i) reasonable court costs, and

"(ii) based upon prevailing market rates for the kind or quality of services furnished—

"(I) the reasonable expenses of expert witnesses in connection with the civil proceeding, except that no expert witness shall be compensated at a rate in excess of the highest rate of compensation for expert witnesses paid by the United States,

"(II) the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and

"(III) reasonable fees paid or incurred for the services of attorneys in connection with the civil proceeding, except that such fees shall not be in excess of $75 per hour unless the court determines that an increase in the cost of living or a special factor, such as the limited availability of qualified attorneys for such proceeding, justifies a higher rate."

(d) DEFINITION OF PREVAILING PARTY.—Subparagraph (A) of section 7430(c)(2) (defining prevailing party) is amended—

(1) by striking out "was unreasonable" in clause (i) and inserting in lieu thereof "was not substantially justified", and

(2) by strikng out "and" at the end of clause (i), by striking out the period at the end of clause (ii) and inserting in lieu thereof", and", and by adding at the end thereof the following new clause:

"(iii) meets the requirements of section 504(b)(1)(B) of title 5, United States Code (as in effect on the date of the enactment of the Tax Reform Act of 1986 and applied by taking into account the commencement of the proceeding described in subsection (a) in lieu of the initiation of the adjudication referred to in such section)."

(e) POSITION OF UNITED STATES INCLUDES ADMINISTRATIVE ACTION.—Section 7430(c) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(4) POSITION OF UNITED STATES.—The term 'position of the United States' includes—

"(A) the position taken by the United States in the civil proceeding, and

"(B) any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subse-

quent administrative action or inaction) upon which such proceeding is based."

(f) Technical Amendment.—*Subsection (a) of section 7430 is amended by inserting "(payable in the case of the Tax Court in the same manner as such an award by a district court)" after "a judgment".*

(g) Provisions Made Permanent.—*Section 7430 is amended by striking out subsection (f).*

(h) Effective Dates.—

(1) General rule.—*Except as provided in paragraph (2), the amendments made by this section shall apply to amounts paid after September 30, 1986, in civil actions or proceedings, commenced after December 31, 1985.*

(2) Subsection *(f).—The amendment made by subsection (f) shall take effect as if included in the amendments made by section 292 of the Tax Equity and Fiscal Responsibility Act of 1982.*

(3) Applicability of amendments to certain prior cases.—*The amendments made by this section shall apply to any case commenced after December 31, 1985, and finally disposed of before the date of the enactment of this Act, except that in any such case, the 30-day period referred to in section 2412(d)(1)(B) of title 28, United States Code, or Rule 231 of the Tax Court, as the case may be, shall be deemed to commence on the date of the enactment of this Act.*

SEC. 1552. FAILURE TO PURSUE ADMINISTRATIVE REMEDIES.

(a) General Rule.—*Section 6673 (relating to damages assessable for instituting proceedings before the Tax Court primarily for delay, etc.) is amended by striking out "or that the taxpayer's position in such proceedings is frivolous or groundless" and inserting in lieu thereof ", that the taxpayer's position in such proceeding is frivolous or groundless, or that the taxpayer unreasonably failed to pursue available administrative remedies".*

(b) Effective Date.—*The amendment made by subsection (a) shall apply to proceedings commenced after the date of the enactment of this Act.*

(c) Report.—*The Secretary of the Treasury or his delegate and the Tax Court shall each prepare a report for 1987 and for each 2-calendar year period thereafter on the inventory of cases in the Tax Court and the measures to close cases more efficiently. Such reports shall be submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.*

SEC. 1553. TAX COURT PRACTICE FEE.

(a) In General.—*Part III of Subchapter C of chapter 76 (relating to miscellaneous provisions) in amended by adding at the end thereof the following new section:*

"SEC. 7475. PRACTICE FEE.

"(a) In General.—*The Tax Court is authorized to impose a periodic registration fee on practitioners admitted to practice before such Court. The frequency and amount of such fee shall be deter-*

mined by the Tax Court, except that such amount may not exceed $30 per year.

"(b) Use of Fees.—The fees described in subsection (a) shall be available to the Tax Court to employ independent counsel to pursue disciplinary matters."

(b) Conforming Amendments.—

(1) The second sentence of section 7472 (relating to expenditures) is amended by striking out "All" and inserting in lieu thereof "Except as provided in section 7475, all".

(2) Section 7473 (relating to disposition of fees) is amended by striking out "All" and inserting in lieu thereof "Except as provided in section 7475, all".

(c) Effective Date.—The amendments made by this section shall take effect on January 1, 1987.

SEC. 1554. CLARIFICATION OF JURISDICTION OVER ADDITION TO TAX FOR FAILURE TO PAY AMOUNT OF TAX SHOWN ON RETURN.

(a) In General.—Subsection (a) of section 6214 (relating to determinations by Tax Court) is amended by striking out "addition to the tax" and inserting in lieu thereof "any addition to the tax".

(b) Effective Date.—The amendment made by subsection (a) shall apply to any action or proceeding in the Tax Court with respect to which a decision has not become final (as determined under section 7481 of the Internal Revenue Code of 1954) before the date of the enactment of this Act.

SEC. 1555. AUTHORITY TO REQUIRE ATTENDANCE OF UNITED STATES MARSHALS AT TAX COURT SESSIONS.

(a) In General.—Subsection (e) of section 7456 (relating to incidental powers) is amended by adding at the end thereof the following new sentence: "The United States marshal for any district in which the Tax Court is sitting shall, when requested by the chief judge of the Tax Court, attend any session of the Tax Court in such district."

(b) Effective Date.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 1556. CHANGES IN CERTAIN PROVISIONS RELATING TO SPECIAL TRIAL JUDGES.

(a) In General.—Part I of subchapter C of chapter 76 (relating to judicial proceedings) is amended by inserting after section 7443 the following new section:

"SEC. 7443A. SPECIAL TRIAL JUDGES.

"(a) Appointment.—The chief judge may, from time to time, appoint special trial judges who shall proceed under such rules and regulations as may be promulgated by the Tax Court.

"(b) Proceedings Which May Be Assigned to Special Trial Judges.—The chief judge may assign—

"(1) any declaratory judgment proceeding,

"(2) any proceeding under section 7463,

"(3) any proceeding where neither the amount of the deficiency placed in dispute (within the meaning of section 7463) nor the amount of any claimed overpayment exceeds $10,000, and

"(4) any other proceeding which the chief judge may designate,

to be heard by the special trial judges of the court.

"(c) AUTHORITY TO MAKE COURT DECISION.—The court may authorize a special trial judge to make the decision of the court with respect to any proceeding described in paragraph (1), (2), or (3) of subsection (b), subject to such conditions and review as the court may provide.

"(d) SALARY.—Each special trial judge shall receive salary—

"(1) at a rate equal to 90 percent of the rate for judges of the Tax Court, and

"(2) in the same installments as such judges.

"(e) EXPENSES FOR TRAVEL AND SUBSISTENCE.—Subsection (d) of section 7443 shall apply to special trial judges subject to such rules and regulations as may be promulgated by the Tax Court."

(b) TECHNICAL AMENDMENTS.—

(1) Section 7456 (relating to administration of oaths and procurement of testimony) is amended by striking out subsections (c) and (d) and by redesignating subsection (e) as subsection (c).

(2) Subsection (c) of section 7471 is amended by striking out "section 7456(c)" and inserting in lieu thereof "subsections (d) and (e) of section 7443A".

(3) The table of sections for part I of subchapter C of chapter 76 is amended by inserting after the item relating to section 7443 the following new item:

"Sec. 7443A. Special trial judges."

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall take effect on the date of the enactment of this Act.

(2) SALARY.—Subsection (d) of section 7443A of the Internal Revenue Code of 1954 (as added by this section) shall take effect on the 1st day of the 1st month beginning after the date of the enactment of this Act.

(3) NEW APPOINTMENTS NOT REQUIRED.—Nothing in the amendments made by this section shall be construed to require the reappointment of any individual serving as a special trial judge of the Tax Court on the day before the date of the enactment of this Act.

SEC. 1557. EFFECT ON RETIRED PAY BY ELECTION TO PRACTICE LAW, ETC., AFTER RETIREMENT.

(a) CHANGE IN AGE AND SERVICE REQUIREMENTS FOR RETIREMENT.—Paragraph (2) of section 7447(b) (relating to retirement) is amended to read as follows:

"(2) Any judge who meets the age and service requirements set forth in the following table may retire:

"The judge has attained age:	*And the years of service as a judge are at least:*
65	*15*
66	*14*
67	*13*
68	*12*
69	*11*
70	*10."*

(b) EFFECT ON RETIRED PAY OF PRACTICING LAW, ETC., AFTER RETIREMENT.—Subsection (f) of section 7447 (relating to individuals re-

ceiving retired pay to be available for recall) is amended to read as follows:

"(f) RETIRED PAY AFFECTED IN CERTAIN CASES.—In the case of an individual for whom an election to receive retired pay under subsection (d) is in effect—

"(1) 1-YEAR FORFEITURE FOR FAILURE TO PERFORM JUDICIAL DUTIES.—If such individual during any calendar year fails to perform judicial duties required of him by subsection (c), such individual shall forfeit all rights to retired pay under subsection (d) for the 1-year period which begins on the 1st day on which he so fails to perform such duties.

"(2) PERMANENT FORFEITURE OF RETIRED PAY WHERE CERTAIN NON-GOVERNMENT SERVICES PERFORMED.—If such individual performs (or supervises or directs the performance of) legal or accounting services in the field of Federal taxation for his client, his employer, or any of his employer's clients, such individual shall forfeit all rights to retired pay under subsection (d) for all periods beginning on or after the 1st day on which he engages in any such activity. The preceding sentence shall not apply to any civil office or employment under the Government of the United States.

"(3) SUSPENSION OF RETIRED PAY DURING PERIOD OF COMPENSATED GOVERNMENT SERVICE.—If such individual accepts compensation for civil office or employment under the Government of the United States (other than the performance of judicial duties pursuant to subsection (c)), such individual shall forfeit all rights to retired pay under subsection (d) for the period for which such compensation is received.

"(4) FORFEITURES OF RETIRED PAY UNDER PARAGRAPHS (1) AND (2) NOT TO APPLY WHERE INDIVIDUAL ELECTS TO FREEZE AMOUNT OF RETIRED PAY.—

"(A) IN GENERAL.—If any individual makes an election under this paragraph—

"(i) paragraphs (1) and (2) (and subsection (c)) shall not apply to such individual beginning on the date such election takes effect, and

"(ii) the retired pay under subsection (d) payable to such individual for periods beginning on or after the date such election takes effect shall be equal to the retired pay to which such individual would be entitled without regard to this clause at the time of such election.

"(B) ELECTION.—An election under this paragraph—

"(i) may be made by an individual only if such individual meets the age and service requirements for retirement under paragraph (2) of subsection (b),

"(ii) may be made only during the period during which the individual may make an election to receive retired pay or while the individual is receiving retired pay, and

"(iii) shall be made in the same manner as the election to receive retired pay.

Such an election, once it takes effect, shall be irrevocable.

"(C) When election takes effect.—Any election under this paragraph shall take effect on the 1st day of the 1st month following the month in which the election is made."

(c) High 3 Years of Salary Must Be During Period When Election To Receive Retired Pay Is Not In Effect.—Subsection (m) of section 7448 (relating to computation of annuities) is amended by adding at the end thereof the following new sentence: "In determining the period of 3 consecutive years referred to in the preceding sentence, there may not be taken into account any period for which an election under section 7447(f)(4) is in effect."

(d) Clerical Amendments.—

(1) Subsection (a) of section 7447 (relating to definitions) is amended by striking out paragraph (2) and by redesignating paragraphs (3) and (5) as paragraphs (2) and (3), respectively.

(2) Subsection (e) of section 7447 is amended by striking out "Civil Service Commission" each place it appears and inserting in lieu thereof "Office of Personnel Management".

(3) Subparagraph (C) of section 7447(g)(2) (relating to coordination with civil service retirement) is amended by striking out "Civil Service Commission" and inserting in lieu thereof "Office of Personnel Management".

(e) Effective Date.—

(1) In general.—The amendments made by this section shall take effect on the date of the enactment of this Act.

(2) Forfeiture of retired pay.—The amendments made by this section shall not apply to any individual who, before the date of the enactment of this Act, forfeited his rights to retired pay under section 7447(d) of the Internal Revenue Code of 1954 by reason of the 1st sentence of section 7447(f) of such Code (as in effect on the day before such date).

SEC. 1558. AUTHORIZATION FOR APPEALS FROM INTERLOCUTORY ORDERS OF THE TAX COURT.

(a) In General.—Subsection (a) of section 7482 (relating to courts of review) is amended by adding at the end thereof the following new paragraph:

"(2) Interlocutory orders.—

"(A) In general.—When any judge of the Tax Court includes in an interlocutory order a statement that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from that order may materially advance the ultimate termination of the litigation, the United States Court of Appeals may, in its discretion, permit an appeal to be taken from such order, if application is made to it within 10 days after the entry of such order. Neither the application for nor the granting of an appeal under this paragraph shall stay proceedings in the Tax Court, unless a stay is ordered by a judge of the Tax Court or by the United States Court of Appeals which has jurisdiction of the appeal or a judge of that court.

"(B) Order treated as tax court decision.—For purposes of subsections (b) and (c), an order described in this paragraph shall be treated as a decision of the Tax Court.

"(C) Venue for review of subsequent proceedings.—If a United States Court of Appeals permits an appeal to be taken from an order described in subparagraph (A), except as provided in subsection (b)(2), any subsequent review of the decision of the Tax Court in the proceeding shall be made by such Court of Appeals."

(b) Clerical Amendments.—The text of subsection (a) of section 7482 (as in effect before the amendment made by subsection (a)) is moved below the subsection heading and 2 ems to the right (so that the left margin of such text is aligned with the left margin of the paragraph (2) added by subsection (a)) and amended by inserting before such text "(1) In general.—".

(c) Effective Date.—The amendments made by this section shall apply to any order of the Tax Court entered after the date of the enactment of this Act.

SEC. 1559. CHANGES RELATING TO ANNUITIES FOR SURVIVING SPOUSES AND DEPENDENT CHILDREN OF TAX COURT JUDGES.

(a) Increases in Salary Deductions, and Authorizations of Appropriations, for Tax Court Judges Survivors Annuity Fund.—

(1) Increases in salary deductions.—

(A) Subsection (c) of section 7448 (relating to salary deductions) is amended by striking out "3 percent" and inserting in lieu thereof "3.5 percent".

(B) Subsection (d) of section 7448 (relating to deposits in survivors annuity fund) is amended by striking out "3 percent" the second place it appears and inserting in lieu thereof "3.5 percent".

(2) Authorization of appropriations.—

(A) In general.—Subsection (c) of section 7448 is amended—

(i) by striking out "(c) Salary Deductions.—There" and inserting in lieu thereof the following:

"(c) Survivors Annuity Fund.—

"(1) Salary deductions.—There",

(ii) by moving the text of such subsection 2 ems to the right, and

(iii) by adding at the end thereof the following new paragraph:

"(2) Appropriations where unfunded liability.—

"(A) In general.—Not later than the close of each fiscal year, there shall be deposited in the Treasury of the United States to the credit of the survivors annuity fund, in accordance with such procedures as may be prescribed by the Comptroller General of the United States, amounts required to reduce to zero the unfunded liability (if any) of such fund. Subject to appropriation Acts, such deposits shall be taken from sums available for such fiscal year for the payment of amounts described in subsection (a)(4), and shall immediately become an integrated part of such fund.

"(B) Exception.—The amount required by subparagraph (A) to be deposited in any fiscal year shall not exceed an

amount equal to 11 percent of the aggregate amounts described in subsection (a)(4) paid during such fiscal year.

"(C) UNFUNDED LIABILITY DEFINED.—For purposes of subparagraph (A), the term 'unfunded liability' means the amount estimated by the Secretary to be equal to the excess (as of the close of the fiscal year involved) of—

"(i) the present value of all benefits payable from the survivors annuity fund (determined on an annual basis in accordance with section 9503 of title 31, United States Code), over

"(ii) the sum of—

"(I) the present values of future deductions under subsection (c) and future deposits under subsection (d), plus

"(II) the balance in such fund as of the close of such fiscal year.

"(D) AMOUNTS NOT CREDITED TO INDIVIDUAL ACCOUNTS.—Amounts appropriated pursuant to this paragraph shall not be credited to the account of any individual for purposes of subsection (g)."

(B) CONFORMING AMENDMENT.—Subsection (h) of section 7448 is amended by striking out "subsection (c)" and inserting in lieu thereof "subsection (c)(1)".

(b) INCREASES IN ANNUITIES PAYABLE FROM SURVIVORS ANNUITY FUND.—

(1) ANNUITIES FOR SURVIVING SPOUSES.—

(A) INCREASE IN ANNUITY.—Subsection (m) of section 7448 (relating to computation of annuities) is amended—

(i) by striking out "1¼ percent" and inserting in lieu thereof "1.5 percent", and

(ii) by striking out "but such annuity shall not" and all that follows down through the end thereof and inserting in lieu thereof "except that such annuity shall not exceed an amount equal to 50 percent of such average annual salary, nor be less than an amount equal to 25 percent of such average annual salary, and shall be further reduced in accordance with subsection (d) (if applicable)."

(B) ANNUITY TO TERMINATE ON REMARRIAGE ONLY IF SPOUSE NOT 55.—The second sentence of section 7448(h) is amended by striking out "or remarriage" and inserting in lieu thereof "or such surviving spouse's remarriage before attaining age 55".

(2) ANNUITIES FOR SURVIVING DEPENDENT CHILDREN.—

(A) ANNUITY WHERE SURVIVING SPOUSE.—Paragraph (2) of section 7448(h) (relating to entitlement to annuity) is amended by striking out all that follows "equal to" and inserting in lieu thereof the following:

"the lesser of—

"(A) 10 percent of the average annual salary of such judge (determined in accordance with subsection (m)), or

"(B) 20 percent of such average annual salary, divided by the number of such children; or".

(B) ANNUITY WHERE NO SURVIVING SPOUSE.—*Paragraph (3) of section 7448(h) is amended by striking out all that follows "equal to" and inserting in lieu thereof the following:*

"the lesser of—

"(A) 20 percent of the average annual salary of such judge (determined in accordance with subsection (m)), or

"(B) 40 percent of such average annual salary, divided by the number of such children."

(c) AUTHORITY TO ELECT TERMINATION OF PARTICIPATION IN SURVIVOR ANNUITY PROGRAM.—

(1) IN GENERAL.—*Subsection (g) of section 7448 is amended by inserting "or if any judge ceases to be married after making the election under subsection (b) and revokes (in a writing filed as provided in subsection (b)) such election" after "1939".*

(2) CONFORMING AMENDMENT.—*The subsection heading for such subsection (g) is amendment by striking out "OF SERVICE".*

(d) EFFECTIVE DATE.—

(1) SALARY DEDUCTIONS.—

(A) The amendment made by subsection (a)(1)(A) shall apply to amounts paid after November 1, 1986.

(B) The amendment made by subsection (a)(1)(B) shall apply to service after November 1, 1986.

(2) APPROPRIATIONS.—*The amendments made by subsection (a)(2) shall apply to fiscal years beginning after 1986.*

(3) COMPUTATION OF ANNUITIES.—*The amendments made by subsection (b) shall apply to annuities the starting date of which is after November 1, 1986.*

(4) OPPORTUNITY TO REVOKE SURVIVOR ANNUITY ELECTION.—

(A) IN GENERAL.—*Any individual who before November 1, 1986, made an election under subsection (b) of section 7448 of the Internal Revenue Code of 1954 may revoke such election. Such a revocation shall constitute a complete withdrawal from the survivor annuity program provided for in such section and shall be filed as provided for elections under such subsection.*

(B) EFFECT OF REVOCATION.—*Any revocation under subparagraph (A) shall have the same effect as if there were a termination to which section 7448(g) of such Code applies on the date such revocation is filed.*

(C) PERIOD REVOCATION PERMITTED.—*Any revocation under subparagraph (A) may be made only during the 180-day period beginning on the date of the enactment of this Act.*

(5) OPPORTUNITY TO ELECT SURVIVOR ANNUITY WHERE PRIOR REVOCATION.—*Any individual who under paragraph (4) revoked an election under subsection (b) of section 7448 of such Code may thereafter make such an election only if such individual deposits to the credit of the survivors annuity fund under subsection (c) of such section the entire amount paid to such individual under paragraph (4), together with interest computed as provided in subsection (d) of such section.*

Subtitle G—Tax Administration Provisions

SEC. 1561. SUSPENSION OF STATUTE OF LIMITATIONS IF THIRD-PARTY RECORDS NOT PRODUCED WITHIN 6 MONTHS AFTER SERVICE OF SUMMONS.

(a) IN GENERAL.—Subsection (e) of section 7609 (relating to special procedures for third-party summonses) is amended to read as follows:

"(e) SUSPENSION OF STATUTE OF LIMITATIONS.—

"(1) SUBSECTION (b) ACTION.—If any person takes any action as provided in subsection (b) and such person is the person with respect to whose liability the summons is issued (or is the agent, nominee, or other person acting under the direction or control of such person), then the running of any period of limitations under section 6501 (relating to the assessment and collection of tax) or under section 6531 (relating to criminal prosecutions) with respect to such person shall be suspended for the period during which a proceeding, and appeals therein, with respect to the enforcement of such summons is pending.

"(2) SUSPENSION AFTER 6 MONTHS OF SERVICE OF SUMMONS.—In the absence of the resolution of the third-party recordkeeper's response to the summons described in subsection (c), the running of any period of limitations under section 6501 or under section 6531 with respect to any person with respect to whose liability the summons is issued other (other than a person taking action as provided in subsection (b)) shall be suspended for the period—

"(A) beginning on the date which is 6 months after the service of such summons, and

"(B) ending with the final resolution of such response."

(b) NOTICE OF SUSPENSION IN THE CASE OF A JOHN DOE SUMMONS.—Section 7609(i) (relating to duty of third-party recordkeeper) is amended by adding at the end thereof the following new paragraph:

"(4) NOTICE OF SUSPENSION OF STATUTE OF LIMITATIONS IN THE CASE OF A JOHN DOE SUMMONS.—In the case of a summons described in subsection (f) with respect to which any period of limitations has been suspended under subsection (e)(2), the third-party recordkeeper shall provide notice of such suspension to any person described in subsection (f)."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 1562. AUTHORITY TO RESCIND NOTICE OF DEFICIENCY WITH TAXPAYER'S CONSENT.

(a) IN GENERAL.—Section 6212 (relating to notice of deficiency) is amended by adding at the end thereof the following new subsection:

"(d) AUTHORITY TO RESCIND NOTICE OF DEFICIENCY WITH TAXPAYER'S CONSENT.—The Secretary may, with the consent of the taxpayer, rescind any notice of deficiency mailed to the taxpayer. Any notice so rescinded shall not be treated as a notice of deficiency for purposes of subsection (c)(1) (relating to further deficiency letters restricted), section 6213(a) (relating to restrictions applicable to deficiencies; petition to Tax Court), and section 6512(a) (relating to limi-

tations in case of petition to Tax Court), and the taxpayer shall have no right to file a petition with the Tax Court based on such notice."

(b) Effective Date.—The amendment made by this section shall apply to notices of deficiency issued on or after January 1, 1986.

SEC. 1563. AUTHORITY TO ABATE INTEREST DUE TO ERRORS OR DELAYS BY THE INTERNAL REVENUE SERVICE.

(a) In General.—Section 6404 (relating to abatements) is amended by adding at the end thereof the following new subsection:

"(e) Assessments of Interest Attributable to Errors and Delays by Internal Revenue Service.—

"(1) In general.—In the case of any assessment of interest on—

"(A) any deficiency attributable in whole or in part to any error or delay by an officer or employee of the Internal Revenue Service (acting in his official capacity) in performing a ministerial act, or

"(B) any payment of any tax described in section 6212(a) to the extent that any delay in such payment is attributable to such an officer or employee being dilatory in performing a ministerial act,

the Secretary may abate the assessment of all or any part of such interest for any period. For purposes of the preceding sentence, an error or delay shall be taken into account only if no significant aspect of such error or delay can be attributed to the taxpayer involved, and after the Internal Revenue Service has contacted the taxpayer in writing with respect to such deficiency or payment.

"(2) Interest abated with respect to erroneous refund check.—The Secretary shall abate the assessment of all interest on any erroneous refund under section 6602 until the date demand for repayment is made, unless—

"(A) the taxpayer (or a related party) has in any way caused such erroneous refund, or

"(B) such erroneous refund exceeds $50,000."

(b) Effective Date.—

(1) In general.—The amendment made by subsection (a) shall apply to interest accruing with respect to deficiencies or payments for taxable years beginning after December 31, 1978.

(2) Statute of limitations.—If refund or credit of any amount resulting from the application of the amendment made by subsection (a) is prevented at any time before the close of the date which is 1 year after the date of the enactment of this Act by the operation of any law or rule of law (including res judicata), refund or credit of such amount (to the extent attributable to the application of the amendment made by subsection (a)) may, nevertheless, be made or allowed if claim therefore is filed before the close of such 1-year period.

SEC. 1564. SUSPENSION OF COMPOUNDING WHERE INTEREST ON DEFICIENCY SUSPENDED.

(a) In General.—Subsection (c) of section 6601 (relating to suspension of interest in certain income, estate, gift, and certain excise taxes cases) is amended by inserting before the period at the end

thereof "and interest shall not be imposed during such period on any interest with respect to such deficiency for any prior period".

(b) EFFECTIVE DATE.—

(1) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to interest accruing after December 31, 1982.

(2) STATUTE OF LIMITATIONS.—If refund or credit of any amount resulting from the application of the amendment made by subsection (a) is prevented at any time before the close of the date which is 1 year after the date of the enactment of this Act by the operation of any law or rule of law (including res judicata), refund or credit of such amount (to the extent attributable to the application of the amendment made by subsection (a)) may, nevertheless, be made or allowed if claim therefore is filed before the close of such 1-year period.

SEC. 1565. CERTAIN SERVICE-CONNECTED DISABILITY PAYMENTS EXEMPT FROM LEVY.

(a) EXEMPTION FROM LEVY.—Subsection (a) of section 6334 (relating to the enumeration of property exempt from levy) is amended by adding at the end thereof the following new paragraph:

"(10) CERTAIN SERVICE-CONNECTED DISABILITY PAYMENTS.—Any amount payable to an individual as a service-connected (within the meaning of section 101(16) of title 38, United States Code) disability benefit under—

"(A) subchapter II, IV, or VI of chapter 11 of such title 38,

"(B) subchapter I, II, or III of chapter 19 of such title 38, or

"(C) chapter 21, 31, 32, 34, 35, 37, or 39 of such title 38."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to amounts payable after December 31, 1986.

SEC. 1566. INCREASE IN VALUE OF PERSONAL PROPERTY SUBJECT TO CERTAIN LISTING AND NOTICE PROCEDURES.

(a) IN GENERAL.—Section 7325 (relating to personal property valued at $2,500 or less) is amended by striking out "$2,500" each place it appears (including the section heading) and inserting in lieu thereof "$100,000".

(b) INCREASE IN AMOUNT OF BOND BY CLAIMANT.—Paragraph (3) of section 7325 is amended by striking out "$250" and inserting in lieu thereof "$2,500".

(c) TECHNICAL AMENDMENT.—Paragraph (4) of section 7103(b) is amended by striking out "$1,000" and inserting in lieu thereof "$100,000".

(d) CLERICAL AMENDMENT.—The item relating to section 7325 in the table of sections for part II of subchapter C of chapter 75 is amended by striking out "$2,500" and inserting in lieu thereof "$100,000".

(e) EFFECTIVE DATE.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 1567. CERTAIN RECORDKEEPING REQUIREMENTS.

(a) IN GENERAL.—For purposes of sections 132 and 274 of the Internal Revenue Code of 1954, use of an automobile by a special agent of the Internal Revenue Service shall be treated in the same

manner as use of an automobile by an officer of any other law enforcement agency.

(b) Effective Date.—The provisions of this section shall take effect on January 1, 1985.

SEC. 1568. DISCLOSURE OF RETURNS AND RETURN INFORMATION TO CERTAIN CITIES.

(a) In General.—Subsection (b) of section 6103 (relating to definitions for confidentiality and disclosure of returns and return information) is amended—

(1) by striking out paragraph (5) and inserting in lieu thereof the following:

"(5) State.—The term 'State' means—

"(A) any of the 50 States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, the Canal Zone, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, the Republic of the Marshall Islands, the Federated States of Micronesia, and the Republic of Palau, and

"(B) for purposes of subsections (a)(2), (b)(4), (d)(1), (h)(4), and (p) any municipality—

"(i) with a population in excess of 2,000,000 (as determined under the most recent decennial United States census data available),

"(ii) which imposes a tax on income or wages, and

"(iii) with which the Secretary (in his sole discretion) has entered into an agreement regarding disclosure.", and

(2) by adding at the end thereof the following new paragraph:

"(10) Chief executive officer.—The term 'chief executive officer' means, with respect to any municipality, any elected official and the chief official (even if not elected) of such municipality."

(b) Effective Date.—The amendments made by this section shall take effect on the date of the enactment of this Act.

SEC. 1569. TREATMENT OF CERTAIN FORFEITURES.

(a) In General.—Subsection (i) of section 6323 is amended by adding at the end thereof the following new paragraph:

"(3) Forfeitures.—For purposes of this subchapter, a forfeiture under local law of property seized by a law enforcement agency of a State, county, or other local governmental subdivision shall relate back to the time of seizure, except that this paragraph shall not apply to the extent that under local law the holder of an intervening claim or interest would have priority over the interest of the State, county, or other local governmental subdivision in the property."

(b) Effective Date.—The amendment made by this section shall take effect on the date of the enactment of this Act.

SEC. 1570. PROCEDURE AT TAX SALE OF SEIZED PROPERTY WHERE NO PERSON OFFERS MINIMUM PRICE.

(a) In General.—Paragraph (1) of section 6335(e) (relating to manner and conditions of sale of seized property) is amended to read as follows:

"(1) In general.—

"(A) DETERMINATIONS RELATING TO MINIMUM PRICE.—Before the sale of property seized by levy, the Secretary shall determine—

"(i) a minimum price for which such property shall be sold (taking into account the expense of making the levy and conducting the sale), and

"(ii) whether, on the basis of criteria prescribed by the Secretary, the purchase of such property by the United States at such minimum price would be in the best interest of the United States.

"(B) SALE TO HIGHEST BIDDER AT OR ABOVE MINIMUM PRICE.—If, at the sale, one or more persons offer to purchase such property for not less than the amount of the minimum price, the property shall be declared sold to the highest bidder.

"(C) PROPERTY DEEMED SOLD TO UNITED STATES AT MINIMUM PRICE IN CERTAIN CASES.—If no person offers the amount of the minimum price for such property at the sale and the Secretary has determined that the purchase of such property by the United States would be in the best interest of the United States, the property shall be declared to be sold to the United States at such minimum price.

"(D) RELEASE TO OWNER IN OTHER CASES.—If, at the sale, the property is not declared sold under subparagraph (B) or (C), the property shall be released to the owner thereof and the expense of the levy and sale shall be added to the amount of tax for the collection of which the levy was made. Any property released under this subparagraph shall remain subject to any lien imposed by subchapter C."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to—

(1) property seized after the date of the enactment of this Act, and

(2) property seized on or before such date which is held by the United States on such date.

SEC. 1571. MODIFICATION OF TIPS ALLOCATION METHOD.

Effective for any payroll period beginning after December 31, 1986, an establishment may utilize the optional method of tips allocation described in the last sentence of section 31.6053–3(f)(1)(iv) of the Internal Revenue Regulations only if such establishment employs less than the equivalent of 25 full-time employees during such payroll period.

SEC. 1572. TREATMENT OF FORFEITURES OF LAND SALES CONTRACTS FOR PURPOSES OF DISCHARGE OF LIENS.

(a) AMENDMENT OF SECTION 7425(c).—Subsection (c) of section 7425 (relating to special rules for discharge of liens) is amended by adding at the end thereof the following new paragraph:

"(4) FORFEITURES OF LAND SALES CONTRACTS.—For purposes of subsection (b), a sale of property includes any forfeiture of a land sales contract."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to forfeitures after the 30th day after the date of the enactment of this Act.

Subtitle H—Miscellaneous Provisions

SEC. 1572. WITHHOLDING ALLOWANCES TO REFLECT NEW RATE SCHEDULES.

(a) In General.—The Secretary of the Treasury or his delegate shall modify the withholding schedules and withholding exemption certificates under section 3402 of the Internal Revenue Code of 1954 to better approximate actual tax liability under the amendments made by this Act.

(b) Certain Decreases in Withholding Not Permitted.—Subsection (i) of section 3402 is amended by striking out "or decreases".

(c) Employer's Responsibility.—If an employee has not filed a revised withholding allowance certificate before October 1, 1987, the employer shall withhold income taxes from the employee's wages—

(1) as if the employee claimed 1 withholding allowance, if the employee checked the "single" box on the employee's previous withholding allowance certificate, or

(2) as if the employee claimed 2 withholding allowances, if the employee checked the "married" box on the employee's previous withholding allowance certificate.

SEC. 1572. REPORT ON RETURN-FREE SYSTEM.

(a) Report.—The Secretary of the Treasury or his delegate shall prepare a report on a return-free system for the Federal income tax of individuals. Such report shall include—

(1) the identification of classes of individuals who would be permitted to use a return-free system,

(2) how such a system would be phased in,

(3) what additional resources the Internal Revenue Service would need to carry out such a system, and

(4) the types of changes to the Internal Revenue Code of 1954 which would inhibit or enhance the use of such a system.

(b) Due Date.—The report under subsection (a) shall be submitted, not later than 6 months after the date of the enactment of this Act, to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

TITLE XVI—EXEMPT AND NONPROFIT ORGANIZATIONS

SEC. 1601. CERTAIN DISTRIBUTIONS OF LOW COST ARTICLES AND EXCHANGES AND RENTALS OF MEMBER LISTS BY CERTAIN ORGANIZATIONS NOT TO BE TREATED AS UNRELATED TRADE OR BUSINESS.

(a) In General.—Section 513 (defining unrelated trade or business) is amended by adding at the end thereof the following new subsection:

"(h) Certain Distributions of Low Cost Articles Without Obligation To Purchase and Exchanges and Rentals of Member Lists.—

"(1) In general.—In the case of an organization which is described in section 501 and contributions to which are deductible

under paragraph (2) or (3) of section 170(c), the term 'unrelated trade or business' does not include—

"(A) activities relating to the distribution of low cost articles if the distribution of such articles is incidental to the solicitation of charitable contributions, or

"(B) any trade or business which consists of—

"(i) exchanging with another such organization names and addresses of donors to (or members of) such organization, or

"(ii) renting such names and addresses to another such organization.

"(2) LOW COST ARTICLE DEFINED.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'low cost article' means any article which has a cost not in excess of $5 to the organization which distributes such item (or on whose behalf such item is distributed).

"(B) AGGREGATION RULE.—If more than 1 item is distributed by or on behalf of an organization to a single distributee in any calendar year, the aggregate of the items so distributed in such calendar year to such distributee shall be treated as 1 article for purposes of subparagraph (A).

"(C) INDEXATION OF $5 AMOUNT.—In the case of any taxable year beginning in a calendar year after 1987, the $5 amount in subparagraph (A) shall be increased by an amount equal to—

"(i) $5, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins.

"(3) DISTRIBUTION WHICH IS INCIDENTAL TO THE SOLICITATION OF CHARITABLE CONTRIBUTIONS DESCRIBED.—For purposes of this subsection, any distribution of low cost articles by an organization shall be treated as a distribution incidental to the solicitation of charitable contributions only if—

"(A) such distribution is not made at the request of the distributee,

"(B) such distribution is made without the express consent of the distributee, and

"(C) the articles so distributed are accompanied by—

"(i) a request for a charitable contribution (as defined in section 170(c)) by the distributee to such organization, and

"(ii) a statement that the distributee may retain the low cost article regardless of whether such distributee makes a charitable contribution to such organization."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to distributions of low cost articles and exchanges and rentals of member lists after the date of the enactment of this Act.

SEC. 1602. EDUCATIONAL ACTIVITIES AT CONVENTION AND TRADE SHOWS.

(a) CERTAIN EDUCATIONAL ACTIVITIES TREATED AS CONVENTION AND TRADE SHOW ACTIVITIES.—Section 513(d)(3)(B) (defining to qualified convention and trade show activity) is amended by insert-

ing after "industry in general" the following: "or to educate persons in attendance regarding new developments or products and services related to the exempt activities of the organization".

(b) QUALIFYING ORGANIZATIONS.—Section 513(d)(3)(C) (defining qualifying organization) is amended—

(1) by striking out "501(c) (5) or (6)" and inserting in lieu thereof "501(c) (3), (4), (5), or (6)", and

(2) by inserting before the period at the end thereof the following: "or which educates persons in attendance regarding new developments or products and services related to the exempt activities of the organization".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to activities in taxable years beginning after the date of the enactment of this Act.

SEC. 1603. TAX EXEMPTION FOR CERTAIN TITLE-HOLDING COMPANIES.

(a) IN GENERAL.—Section 501(c) (relating to the list of exempt organizations) is amended by adding at the end thereof the following new paragraph:

"(25)(A) Any corporation or trust which—

"(i) has no more than 35 shareholders or beneficiaries,

"(ii) has only 1 class of stock or beneficial interest, and

"(iii) is organized for the exclusive purposes of—

"(I) acquiring real property and holding title to, and collecting income from, such property, and

"(II) remitting the entire amount of income from such property (less expenses) to 1 or more organizations described in subparagraph (C) which are shareholders of such corporation or beneficiaries of such trust.

"(B) A corporation or trust shall be described in subparagraph (A) without regard to whether the corporation or trust is organized by 1 or more organizations described in subparagraph (C).

"(C) An organization is described in this subparagraph if such organization is—

"(i) a qualified pension, profit sharing, or stock bonus plan that meets the requirements of section 401(a),

"(ii) a governmental plan (within the meaning of section 414(d)),

"(iii) the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing,

"(iv) any organization described in paragraph (3), or

"(v) any organization described in this paragraph.

"(D) A corporation or trust described in this paragraph must permit its shareholders or beneficiaries—

"(i) to dismiss the corporation's or trust's investment adviser, following reasonable notice, upon a vote of the shareholders or beneficiaries holding a majority of interest in the corporation or trust, and

"(ii) to terminate their interest in the corporation or trust by either, or both, of the following alternatives, as determined by the corporation or trust:

"(I) by selling or exchanging their stock in the corporation or interest in the trust (subject to any Federal or State securities law) to any organization described in subparagraph (C) so long as the sale or exchange does not increase the number of shareholders or beneficiaries in such corporation or trust above 35, or

"(II) by having their stock or interest redeemed by the corporation or trust after the shareholder or beneficiary has provided 90 days notice to such corporation or trust."

(b) CLERICAL AMENDMENT.—Subparagraph (C) of section 514(c)(9) (relating to real property acquired by a qualified organization) is amended—

(1) by striking out "or" at the end of clause (i),

(2) by striking out the period following clause (ii) and inserting in lieu thereof "; or", and

(3) by adding at the end thereof the following new clause:

"(iii) an organization described in section 501(c)(25)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1986.

SEC. 1604. EXCEPTION TO MEMBERSHIP ORGANIZATION DEDUCTION RULES.

(a) IN GENERAL.—Subsection (b) of section 277 (relating to deductions incurred by certain membership organizations in transactions with members) is amended—

(1) by striking out "or" at the end of paragraph (2),

(2) by striking out the period at the end of paragraph (3) and inserting in lieu thereof ", or", and

(3) by adding at the end thereof the following new paragraph:

"(4) which is engaged primarily in the gathering and distribution of news to its members for publication."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

SEC. 1605. TAX-EXEMPT STATUS FOR AN ORGANIZATION INTRODUCING INTO PUBLIC USE TECHNOLOGY DEVELOPED BY QUALIFIED ORGANIZATIONS.

(a) IN GENERAL.—For purposes of the Internal Revenue Code of 1986, an organization shall be treated as an organization organized and operated exclusively for charitable purposes if such organization—

(1) is organized and operated exclusively—

(A) to provide for (directly or by arranging for and supervising the performance by independent contractors)—

(i) reviewing technology disclosures from qualified organizations,

(ii) obtaining protection for such technology through patents, copyrights, or other means, and

(iii) licensing, sale, or other exploitation of such technology,

(B) to distribute the income therefrom, to such qualified organizations after paying expenses and other amounts as agreed with the originating qualified organizations, and

(C) to make research grants to such qualified organizations,

(2) regularly provides the services and research grants described in paragraph (1) exclusively to 1 or more qualified organizations, except that research grants may be made to such qualified organizations through an organization which is controlled by 1 or more organizations each of which—

(A) is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986 or the income of which is excluded from taxation under section 115 of such Code, and

(B) may be a recipient of the services or research grants described in paragraph (1),

(3) derives at least 80 percent of its gross revenues from providing services to qualified organizations located in the same State as the State in which such organization has its principal office, and

(4) was incorporated on July 20, 1981.

(b) QUALIFIED ORGANIZATIONS.—For purposes of this section, the term "qualified organization" has the same meaning given to such term by subparagraphs (A) and (B) of section 41(e)(6) (as redesignated by section 231(d)(2)) of the Internal Revenue Code of 1986.

(c) TREATMENT OF INVESTMENT IN A TECHNOLOGY TRANSFER SERVICE ORGANIZATION.—

(1) IN GENERAL.—A qualified investment made by a private foundation in an organization described in subparagraph (C) shall be treated as an investment described in section 4944(c) of the Internal Revenue Code of 1986 and shall not result in imposition of taxes under section 4941, 4943, 4944, 4945, or 507(c) of such Code.

(2) DEFINITIONS.—For purposes of this subsection—

(A) QUALIFIED INVESTMENT.—The term "qualified investment" means a transfer by a private foundation of—

(i) all of the patents, copyrights, know-how, and other technology or rights thereto of the private foundation, and

(ii) investment assets, net receivables, and cash not exceeding $35,000,000,

to such organization in exchange for debt.

(B) PRIVATE FOUNDATION.—The term "private foundation" means—

(i) a nonprofit corporation which was incorporated before 1913 which is described in sections 501(c)(3) and 509(a) of such Code, and which is exempt from taxation under section 501(a) of such Code, and

(ii) the principal purposes of which are to support research by and to provide technology transfer services to organizations described in section 170(b)(1)(A) of such Code—

(I) which are exempt from taxation under section 501(a) of such Code, or

(II) the income of which is excluded from taxation under section 115 of such Code.

(C) Technology transfer organization.—The term "technology transfer organization" means a corporation established after the date of the enactment of this Act—

(i) which is organized and operated to advance the public welfare through the provision of technology transfer services to research organizations,

(ii) no part of the net earnings of which inures to the benefit of, or is distributable to, any private shareholder, individual, or entity, other than a private foundation or research organization,

(iii) which does not participate in, or intervene in (including the publishing or distributing of statements) any political campaign on behalf of any candidate for public office,

(iv) no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, and

(v) upon liquidation or dissolution of which all of its net assets can be distributed only to research organizations.

(d) Effective Date.—This section shall take effect on the date of the enactment of this Act.

SEC. 1606. DEFINITION OF GOVERNMENT OFFICIAL.

(a) In General.—Paragraph (5) of section 4946(c) of the Internal Revenue Code of 1986 (relating to government official) is amended by striking out "$15,000" and inserting in lieu thereof "$20,000".

(b) Effective Date.—The amendment made by this section shall apply to compensation received after December 31, 1985.

SEC. 1607. TRANSITION RULE FOR ACQUISITION INDEBTEDNESS WITH RESPECT TO CERTAIN LAND.

For purposes of applying section 514(c) of the Internal Revenue Code of 1986, with respect to a disposition during calendar year 1986 or calendar year 1987 of land acquired during calendar year 1984, the term "acquisition indebtedness" does not include indebtedness incurred in connection with bonds issued after January 1, 1984, and before July 19, 1984, on behalf of an organization which is a community college and which is described in section 511(a)(2)(B) of such Code.

SEC. 1608. TREATMENT OF CERTAIN AMOUNTS PAID TO OR FOR THE BENEFIT OF CERTAIN INSTITUTIONS OF HIGHER EDUCATION.

(a) In General.—Amounts paid by a taxpayer to or for the benefit of an institution of higher education described in paragraph (1) or (2) of subsection (b) (other than amounts separately paid for tickets) which would otherwise qualify as a charitable contribution within the meaning of section 170 of the Internal Revenue Code of 1986 shall not be disqualified because such taxpayer receives the right to seating or the right to purchase seating in an athletic stadium of such institution.

(b) Described Institutions.—

(1) An institution is described in this paragraph, if—

(A) such institution was mandated by a State constitution in 1876,

(B) such institution was established by a State legislature in March 1881, and is located in a State capital pursuant to a statewide election in September 1981,

(C) the campus of such institution formally opened on September 15, 1883, and

(D) such institution is operated under the authority of a 9-member board of regents appointed by the governor.

(2) An institution is described in this paragraph if such institution has an athletic stadium—

(A) the plans for renovation of which were approved by a board of supervisors in December 1984, and reaffirmed by such board in December 1985 and January 1986, and

(B) the plans for renovation of which were approved by a State board of ethics for public employees in February 1986.

(c) EFFECTIVE DATE.—The provisions of this section shall apply to amounts paid in taxable years beginning on or after January 1, 1984.

TITLE XVII—MISCELLANEOUS PROVISIONS

SEC. 1701. EXTENSION AND MODIFICATION OF TARGETED JOBS CREDIT.

(a) 3-YEAR EXTENSION.—Paragraph (3) of section 51(c) (relating to termination) is amended by striking out "December 31, 1985" and inserting in lieu thereof "December 31, 1988".

(b) CREDIT FOR FIRST-YEAR WAGES ONLY.—

(1) IN GENERAL.—Section 51(a) (relating to determination of amount of credit) is amended to read as follows:

"(a) DETERMINATION OF AMOUNT.—For purposes of section 38, the amount of the targeted jobs credit determined under this section for the taxable year shall be equal to 40 percent of the qualified first-year wages for such year."

(2) CONFORMING AMENDMENTS.—

(A) Subsection (b) of section 51 (defining qualified wages) is amended—

(i) by striking out paragraph (3) and by redesignating paragraph (4) as paragraph (3), and

(ii) by striking out ", and the amount of the qualified second-year wages," in paragraph (3) (as so redesignated).

(B) Subparagraph (B) of section 51(d)(12) (relating to qualified summer youth employee) is amended—

(i) by striking out "50 percent" in clause (i) thereof and inserting in lieu thereof "40 percent",

(ii) by striking out clause (ii) and redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively, and

(iii) by striking out "subsection (b)(4)" and inserting in lieu thereof "subsection (b)(3)" in clause (iii) (as so redesignated).

(c) ELIGIBLE INDIVIDUALS—PERIOD OF EMPLOYMENT.—Subsection (i) of section 51 (relating to certain individuals ineligible) is amended by adding at the end thereof the following new paragraph:

"(3) INDIVIDUALS NOT MEETING MINIMUM EMPLOYMENT PERIOD.—No wages shall be taken into account under subsection (a) with respect to any individual unless such individual either—

"(A) is employed by the employer at least 90 days (14 days in the case of an individual described in subsection (d)(12)), or

"(B) has completed at least 120 hours (20 hours in the case of an individual described in subsection (d)(12)) of services performed for the employer."

(d) EXTENSION OF AUTHORIZATION.—Paragraph (2) of section 261(f) of the Economic Recovery Tax Act of 1981 is amended by striking out "fiscal years 1983, 1984, and 1985" and inserting in lieu thereof "fiscal years 1983, 1984, 1985, 1986, 1987, and 1988".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to individuals who begin work for the employer after December 31, 1985.

SEC. 1702. CERTAIN DIESEL FUEL TAXES MAY BE IMPOSED ON SALES TO RETAILERS.

(a) IN GENERAL.—Section 4041 (relating to imposition of tax on special fuels) is amended by adding at the end thereof the following new subsection:

"(n) TAX ON DIESEL FUEL FOR HIGHWAY VEHICLE USE MAY BE IMPOSED ON SALE TO RETAILER.—Under regulations prescribed by the Secretary—

"(1) IN GENERAL.—Upon the written consent of the seller, the tax imposed by subsection (a)(1)—

"(A) shall apply to the sale of diesel fuel to a qualified retailer (and such sale shall be treated as described in subsection (a)(1)(A)), and

"(B) shall not apply to the sale of diesel fuel by such retailer or the use of diesel fuel described in subsection (a)(1)(B) if tax was imposed on such fuel under subparagraph (A) of this paragraph.

"(2) LIABILITY FOR VIOLATION OF CERTIFICATION.—Notwithstanding paragraph (1), a qualified retailer shall be liable for the tax on liquid described in paragraph (3)(C)(ii) if such liquid is used as fuel in a diesel-powered highway vehicle.

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) QUALIFIED RETAILER.—The term 'qualified retailer' means any retailer—

"(i) who elects (under such terms and conditions as may be prescribed by the Secretary) to have paragraph (1) apply to all sales of diesel fuel to such retailer by any person, and

"(ii) who agrees to provide a written notice to such person that paragraph (1) applies to all sales of diesel fuel by such person to such retailer.

Such election and notice shall be effective for such period or periods as may be prescribed by the Secretary.

"(B) RETAILER.—The term 'retailer' means any person who sells diesel fuel for use as a fuel in a diesel-powered

highway vehicle. Such term does not include any person who sells diesel fuel primarily for resale.

"(C) DIESEL FUEL.—

"(i) IN GENERAL.—The term 'diesel fuel' means any liquid on which tax would be imposed by subsection (a)(1) if sold to a person, and for a use, described in subsection (a)(1)(A).

"(ii) EXCEPTION.—A liquid shall not be treated as diesel fuel for purposes of this subsection if the retailer certifies in writing to the seller of such liquid that such liquid will not be sold for use as a fuel in a diesel-powered highway vehicle.

"(4) FAILURE TO NOTIFY SELLER.—

"(A) IN GENERAL.—If a qualified retailer fails to provide the notice described in paragraph (3)(A)(ii) to any seller of diesel fuel to such retailer—

"(i) paragraph (1) shall not apply to sales of diesel fuel by such seller to such retailer during the period for which such failure continues, and

"(ii) any diesel fuel sold by such seller to such retailer during such period shall be treated as sold by such retailer (in a sale described in subsection (a)(1)(A)) on the date such fuel was sold to such retailer.

"(B) PENALTY.—For penalty for failing to notify seller, see section 6652(j).

"(5) EXEMPTIONS NOT TO APPLY.—

"(A) IN GENERAL.—No exemption from the tax imposed by subsection (a)(1) shall apply to a sale to which paragraph (1) or (4)(A) of this subsection applies.

"(B) CROSS REFERENCE.—

"For provisions allowing a credit or refund for certain sales and uses of fuel, see sections 6416 and 6427."

(b) PENALTY.—Section 6652 (relating to failure to file certain information returns, registration statements, etc.), as amended by section 1501(d), is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) FAILURE TO GIVE WRITTEN NOTICE TO CERTAIN SELLERS OF DIESEL FUEL.—

"(1) IN GENERAL.—If any qualified retailer fails to provide the notice described in section 4041(n)(3)(A)(ii) to any seller of diesel fuel to such retailer, unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid, on notice and demand of the Secretary and in the same manner as tax, by such retailer with respect to each sale of diesel fuel to such retailer by such seller to which section 4041(n)(4) applies an amount equal to 5 percent of the tax imposed by section 4041(a)(1) on such sale by reason of paragraphs (3) and (4)(A) of section 4041(n).

"(2) DEFINITIONS.—For purposes of paragraph (1), the terms 'qualified retailer' and 'diesel fuel' have the respective meanings given such terms by section 4041(n)."

(c) Effective Date.—The amendments made by this section shall apply to sales after the first calendar quarter beginning more than 60 days after the date of the enactment of this Act.

SEC. 1703. GASOLINE TAX GENERALLY COLLECTED AT TERMINAL LEVEL.

(a) In General.—Subpart A of part III of subchapter A of chapter 32 (relating to manufacturers excise taxes) is amended to read as follows:

"Subpart A—Gasoline

"Sec. 4081. Imposition of tax.
"Sec. 4082. Definitions.
"Sec. 4083. Cross references.

"SEC. 4081. IMPOSITION OF TAX.

"(a) Tax Imposed.—

"(1) In general.—There is hereby imposed a tax of 9 cents a gallon on the earlier of—

"(A) the removal, or

"(B) the sale,

of gasoline by the refiner or importer thereof or the terminal operator.

"(2) Bulk transfer to terminal operator.—For purposes of paragraph (1), the bulk transfer of gasoline to a terminal operator by a refiner or importer shall not be considered a removal or sale of gasoline by such refiner or importer.

"(b) Treatment of Removal or Subsequent Sale by Blender or Compounder.—

"(1) In general.—There is hereby imposed a tax of 9 cents a gallon on gasoline removed or sold by the blender or compounder thereof.

"(2) Credit for tax previously paid.—If—

"(A) tax is imposed on the removal or sale of gasoline by reason of paragraph (1), and

"(B) the blender or compounder establishes the amount of the tax paid with respect to such gasoline by reason of subsection (a),

the amount of the tax so paid shall be allowed as a credit against the tax imposed by reason of paragraph (1).

"(c) Gasoline Mixed With Alcohol at Refinery, Etc.—

"(1) In general.—Under regulations prescribed by the Secretary, subsection (a) shall be applied by substituting '3 cents' for '9 cents' in the case of the removal or sale of any gasoline for use in producing gasohol at the time of such removal or sale. For purposes of this paragraph, the term 'gasohol' means any mixture of gasoline if at least 10 percent of such mixture is alcohol.

"(2) Later separation of gasoline from gasohol.—If any person separates the gasoline from a mixture of gasoline and alcohol on which tax was imposed under subsection (a) at a rate equivalent to 3 cents a gallon by reason of this subsection (or with respect to which a credit or payment was allowed or made by reason of section 6427(f)(1)), such person shall be treated as the refiner of such gasoline. The amount of tax imposed on any

sale of such gasoline by such person shall be 5 2/3 cents a gallon.

"(3) ALCOHOL DEFINED.—For purposes of this subsection, the term 'alcohol' includes methanol and ethanol but does not include alcohol produced from petroleum, natural gas, or coal (including peat). Such term does not include alcohol with a proof of less than 190 (determined without regard to any added denaturants).

"(4) TERMINATION.—Paragraph (1) shall not apply to any removal or sale after December 31, 1992.

"(d) TERMINATION.—On and after October 1, 1988, the taxes imposed by this section shall not apply.

"SEC. 4082. DEFINITIONS.

"(a) GASOLINE.—For purposes of this subpart, the term 'gasoline' includes, to the extent prescribed in regulations—

"(1) gasoline blend stocks, and

"(2) products commonly used as additives in gasoline.

For purposes of paragraph (1), the term 'gasoline blend stocks' means any petroleum product component of gasoline.

"(b) CERTAIN USES DEFINED AS REMOVAL.—If a refiner, importer, terminal operator, blender, or compounder uses (other than in the production of gasoline or special fuels referred to in section 4041) gasoline refined, imported, blended, or compounded by him, such use shall for the purposes of this chapter be considered a removal.

"SEC. 4083. CROSS REFERENCES.

"(1) For provisions to relieve farmers from excise tax in the case of gasoline used on the farm for farming purposes, see section 6420.

"(2) For provisions to relieve purchasers of gasoline from excise tax in the case of gasoline used for certain nonhighway purposes, used by local transit systems, or sold for certain exempt purposes, see section 6421.

"(3) For provisions to relieve purchasers of gasoline from excise tax in the case of gasoline not used for taxable purposes, see section 6427."

(b) BOND REQUIREMENTS.—

(1) IN GENERAL.—Section 4101 is amended to read as follows:

"SEC. 4101. REGISTRATION AND BOND.

"(a) REGISTRATION.—Every person subject to tax under section 4081 shall, before incurring any liability for tax under such section, register with the Secretary.

"(b) BOND.—Under regulations prescribed by the Secretary, every person who registers under subsection (a) may be required to give a bond in such sum as the Secretary determines."

(2) CLERICAL AMENDMENT.—The table of sections for subpart C of part III of subchapter A of chapter 32 is amended by striking out the item relating to section 4101 and inserting in lieu thereof the following new item:

"Sec. 4101. Registration and bond."

(c) GASOLINE SOLD FOR CERTAIN EXEMPT PURPOSES.—

(1) IN GENERAL.—Section 6421 (relating to gasoline used for certain nonhighway purposes or by local transit systems) is amended—

(A) by redesignating subsections (c), (d), (e), (f), (g), and (h) as subsections (d), (e), (f), (g), (h), and (i), respectively, and

(B) by inserting after subsection (b), the following new subsection:

"(c) Exempt Purposes.—If gasoline is sold to any person for any purpose described in paragraph (2), (3), (4), or (5) of section 4221(a), the Secretary shall pay (without interest) to such person an amount equal to the product of the number of gallons of gasoline so sold multiplied by the rate at which tax was imposed on such gasoline by section 4081."

(2) Conforming amendments.—

(A) Paragraph (1) of section 6421(d) (relating to time for filing claims; period covered), as redesignated by paragraph (1) of this subsection, is amended by striking out "and not more than one claim may be filed under subsection (b)" and inserting in lieu thereof "not more than one claim may be filed under subsection (b), and not more than one claim may be filed under subsection (c)".

(B) Section 6421(f) (relating to exempt sales; other payments or refunds available), as redesignated by paragraph (1) of this subsection, is amended by striking out paragraph (1) and redesignating paragraphs (2) and (3) as paragraphs (1) and (2), respectively.

(C) Subsection (a) of section 4221 (relating to certain tax-free sales) is amended—

(i) by inserting "or 4081" after "section 4121" in the first sentence, and

(ii) by striking out "4071, or 4081" in the last sentence and inserting in lieu thereof "or 4071".

(D) The heading for section 6421 is amended to read as follows:

"SEC. 6421. GASOLINE USED FOR CERTAIN NONHIGHWAY PURPOSES, USED BY LOCAL TRANSIT SYSTEMS, OR SOLD FOR CERTAIN EXEMPT PURPOSES."

(E) The table of contents for subchapter B of chapter 65 is amended by striking out the item relating to section 6421 and inserting in lieu thereof the following new item:

"Sec. 6421. Gasoline used for certain nonhighway purposes, used by local transit systems, or sold for certain exempt purposes."

(d) Time for Filing Gasohol Credit.—

(1) In general.—Section 6427(h) (relating to time for filing claims; period covered) is amended by adding at the end thereof the following new paragraph:

"(3) Special rule for gasohol credit.—

"(A) In general.—A claim may be filed under subsection (f) by any person with respect to gasoline used to produce gasohol (as defined in section 4081(c)(1)) for any period—

"(i) for which $200 or more is payable under such subsection (f), and

"(ii) which is not less than 1 week.

"(B) Payment of claim.—Notwithstanding subsection (f)(1), if the Secretary has not paid pursuant to a claim filed under this section within 20 days of the date of the filing of such claim, the claim shall be paid with interest from such date determined by using the overpayment rate and method under section 6621."

(B) Conforming amendments.—

(i) Paragraph (1) of section 6427(h) is amended by striking out "(f)".

(ii) Paragraph (2)(A) of section 6427(h) is amended—

(I) by inserting "or" at the end of subclause (i),

(II) by striking out "or" at the end of subclause (ii), and

(III) by striking out clause (iii) and "(or clauses)".

(iii) Paragraph (2)(B) of section 6427(f) is amended by striking out "or clause (iii)".

(iv) Paragraph (2) of section 6427(j) is amended by striking out "subsection (h)(2)" and inserting in lieu thereof "subsection (h)(2) or (h)(3)".

(e) CREDIT FOR GASOLINE BLEND STOCKS OR ADDITIVES NOT USED FOR PRODUCING GASOLINE.—

(1) IN GENERAL.—Section 6427 (relating to fuels not used for taxable purposes) is amended—

(A) by redesignating subsections (h), (i), (j), (k), (l), (m), and (n) as subsections (i), (j), (k), (l), (m), (n), and (o), respectively, and

(B) by inserting after subsection (g) the following new subsection:

"(h) GASOLINE BLEND STOCKS OR ADDITIVES NOT USED FOR PRODUCING GASOLINE.—Except as provided in subsection (k), if any gasoline blend stock or additive (within the meaning of section 4082(b)) is not used by any person to produce gasoline and such person establishes that the ultimate use of such gasoline blend stock or additive is not to produce gasoline, the Secretary shall pay (without interest) to such person an amount equal to the aggregate amount of the tax imposed on such person with respect to such gasoline blend stock or additive."

(2) CONFORMING AMENDMENTS.—

(A) Subsections (a), (b)(1), (c), (d), (e)(1), (f)(1), and (g)(1) of section 6427 are each amended by striking out "subsection (j)" and inserting in lieu thereof "subsection (k)".

(B) Subsection (i)(1) of section 6427 (as redesignated by subsection (d)(1)(A)) is amended by striking out "or (g)" and inserting in lieu thereof "(g), or (h)".

(C) Subsections (i)(2)(A)(i) and (n) of section 6427 (as so redesignated) are amended by striking out "and (g)" each place it appears and inserting in lieu thereof "(g), and (h)".

(D) The heading of subsection (n) of section 6427 (as so redesignated) is amended by striking out "AND (g)" and inserting in lieu thereof "(g), AND (h)".

(E) Subsection (i)(2) of section 6427 (as so redesignated) is amended by striking out "subsection (h)(2)" and inserting in lieu thereof "(i)(2)".

(F) Section 34(a)(3) is amended by striking out "section 6427(j)" and inserting in lieu thereof "section 6427(k)".

(G) Sections 7210, 7603, 7604(b), 7604(c)(2), 7605(a), 7609(c)(1), and 7610(c) are amended by striking out "section 6427(i)(2)" and inserting in lieu thereof "section 6427(j)(2)".

(f) FLOOR STOCK TAXES.—

(1) In general.—On gasoline subject to tax under section 4081 of the Internal Revenue Code of 1986 which, on January 1, 1988, is held by a dealer for sale, and with respect to which no tax has been imposed under such section, there is hereby imposed a floor stocks tax at the rate of 9 cents a gallon.

(2) Overpayment of floor stocks taxes.—Section 6416 of such Code shall apply in respect of the floor stocks taxes imposed by this section, so as to entitle, subject to all provisions of such section, any person paying such floor stocks taxes to a credit or refund thereof for any reasons specified in such section.

(3) Due date of taxes.—The taxes imposed by this subsection shall be paid before February 16, 1988.

(4) Transfer of floor stocks taxes to highway trust fund.—For purposes of determining the amount transferred to the Highway Trust Fund for any period, the taxes imposed by this subsection shall be treated as if they were imposed by section 4081 of the Internal Revenue Code of 1986.

(5) Definitions and special rule.—For purposes of this subsection—

(A) Dealer.—The term "dealer" includes a wholesaler, jobber, distributor, or retailer.

(B) Held by a dealer.—Gasoline shall be considered as "held by a dealer" if title thereto has passed to such dealer (whether or not delivery to him has been made) and if for purposes of consumption title to such gasoline or possession thereof has not at any time been transferred to any person other than a dealer.

(C) Gasoline.—The term "gasoline" has the same meaning given to such term by section 4082(a) of the Internal Revenue Code of 1986.

(g) Study of Evasion of Gasoline Tax.—

(1) In general.—The Secretary of the Treasury or his delegate shall conduct a study of the incidence of the evasion of the gasoline tax.

(2) Report.—The report of the study under paragraph (1) shall be submitted, not later than December 31, 1986, to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

(h) Effective Date.—The amendments made by this section shall apply to gasoline removed (as defined in section 4082 of the Internal Revenue Code of 1986, as amended by this section) after December 31, 1987.

SEC. 1704. EXEMPTION FROM SOCIAL SECURITY COVERAGE FOR CERTAIN CLERGY.

(a) Conditions for Receiving Exemption.—

(1) In general.—Section 1402(e)(1) (relating to exemption from tax on self-employment income of certain ministers, members of religious orders, and Christian Science practitioners) is amended by inserting "and, in the case of an individual described in subparagraph (A), that he has informed the ordaining, commissioning, or licensing body of the church or order that he is opposed to such insurance" after "Act)".

(2) VERIFICATION OF APPLICATION.—Section 1402(e), as amended by paragraph (1) of this subsection, is further amended—

(A) by striking out "Any individual" in paragraph (1) and inserting in lieu thereof "Subject to paragraph (2), any individual",

(B) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and

(C) by inserting after paragraph (1) the following new paragraph:

"(2) VERIFICATION OF APPLICATION.—The Secretary may approve an application for an exemption filed pursuant to paragraph (1) only if the Secretary has verified that the individual applying for the exemption is aware of the grounds on which the individual may receive an exemption pursuant to this subsection and that the individual seeks exemption on such grounds. The Secretary (or the Secretary of Health and Human Services under an agreement with the Secretary) shall make such verification by such means as prescribed in regulations."

(3) EFFECTIVE DATE.—The amendments made by paragraphs (1) and (2) shall apply to applications filed after December 31, 1986.

(b) REVOCATION OF EXEMPTION.—

(1) IN GENERAL.—Notwithstanding section 1402(e)(3) of the Internal Revenue Code of 1986, as redesignated by subsection (a)(2)(B) of this section, any exemption which has been received under section 1402(e)(1) of such Code by a duly ordained, commissioned, or licensed minister of a church, a member of a religious order, or a Christian Science practitioner, and which is effective for the taxable year in which this Act is enacted, may be revoked by filing an application therefor (in such form and manner, and with such official, as may be prescribed in regulations made under chapter 2 of subtitle A of such Code), if such application is filed—

(A) before the applicant becomes entitled to benefits under section 202(a) or 223 of the Social Security Act (without regard to section 202(j)(1) or 223(b) of such Act), and

(B) no later than the due date of the Federal income tax return (including any extension thereof) for the applicant's first taxable year beginning after the date of the enactment of this Act.

Any such revocation shall be effective (for purposes of chapter 2 of subtitle A of the Internal Revenue Code of 1986 and title II of the Social Security Act), as specified in the application, either with respect to the applicant's first taxable year ending on or after the date of the enactment of this Act or with respect to the applicant's first taxable year beginning after such date, and for all succeeding taxable years; and the applicant for any such revocation may not thereafter again file application for an exemption under such section 1402(e)(1). If the application is filed on or after the due date of the Federal income tax return for the applicant's first taxable year ending on or after the date of the enactment of this Act and is effective with respect to that taxable year, it shall include or be accompanied by payment in full of an amount equal to the total of the taxes that would *have been imposed by section 1401 of the Internal Revenue Code of 1986 with respect to all of the applicant's income derived in that taxable year which would have constituted net earnings from self-employment for purposes of chapter 2 of subtitle A of such Code (notwithstanding paragraph (4) or (5) of section 1402(c) of such Code) but for the exemption under section 1402(e)(1) of such Code.*

(2) EFFECTIVE DATE.—Paragraph (1) of this subsection shall apply with respect to service performed (to the extent specified in such paragraph) in taxable years ending on or after the date of the enactment of this Act and with respect to monthly insurance benefits payable under title II of the Social Security Act on the basis of the wages and self-employment income of any individual for months in or after the calendar year in which such individual's application for revocation (as described in such paragraph) is effective (and lump-sum death payments payable under such title on the basis of such wages and self-employment income in the case of deaths occurring in or after such calendar year).

SEC. 1705. APPLICABILITY OF UNEMPLOYMENT COMPENSATION TAX TO CERTAIN SERVICES PERFORMED FOR CERTAIN INDIAN TRIBAL GOVERNMENTS.

(a) IN GENERAL.—For purposes of the Federal Unemployment Tax Act, service performed in the employ of a qualified Indian tribal government shall not be treated as employment (within the meaning of section 3306 of such Act) if it is service—

(1) which is performed—

(A) before, on, or after the date of the enactment of this Act, but before January 1, 1988, and

(B) during a period in which the Indian tribal government is not covered by a State unemployment compensation program, and

(2) with respect to which the tax imposed under the Federal Unemployment Tax Act has not been paid.

(b) DEFINITION.—For purposes of this section, the term "qualified Indian tribal government" means an Indian tribal government the service for which is not covered by a State unemployment compensation program on June 11, 1986.

SEC. 1706. TREATMENT OF CERTAIN TECHNICAL PERSONNEL.

(a) IN GENERAL.—Section 530 of the Revenue Act of 1978 is amended by adding at the end thereof the following new subsection:

"(d) EXCEPTION.—This section shall not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to remuneration paid and services rendered after December 31, 1986.

SEC. 1707. EXCLUSION FOR CERTAIN FOSTER CARE PAYMENTS.

(a) IN GENERAL.—Section 131 (relating to certain foster care payments) is amended to read as follows:

"SEC. 131. CERTAIN FOSTER CARE PAYMENTS.

"(a) General Rule.—Gross income shall not include amounts received by a foster care provider during the taxable year as qualified foster care payments.

"(b) Qualified Foster Care Payment Defined.—For purposes of this section—

"(1) In general.—The term 'qualified foster care payment' means any amount—

"(A) which is paid by a State or political subdivision thereof or by a placement agency which is described in section 501(c)(3) and exempt from tax under section 501(a), and

"(B) which is—

"(i) paid to the foster care provider for caring for a qualified foster individual in the foster care provider's home, or

"(ii) a difficulty of care payment.

"(2) Qualified foster individual.—The term 'qualified foster individual' means any individual who is living in a foster family home in which such individual was placed by—

"(A) an agency of a State or political subdivision thereof, or

"(B) in the case of an individual who has not attained age 19, an organization which is licensed by a State (or political subdivision thereof) as a placement agency and which is described in section 501(c)(3) and exempt from tax under section 501(a).

"(3) Limitation based on number of individuals over the age of 18.—In the case of any foster home in which there is a qualified foster care individual who has attained age 19, foster care payments (other than difficulty of care payments) for any period to which such payments relate shall not be excludable from gross income under subsection (a) to the extent such payments are made for more than 5 such qualified foster individuals."

"(c) Difficulty of Care Payments.—For purposes of this section—

"(1) Difficulty of care payments.—The term 'difficulty of care payments' means payments to individuals which are not described in subsection (b)(1)(B)(i), and which—

"(A) are compensation for providing the additional care of a qualified foster individual which is—

"(i) required by reason of a physical, mental, or emotional handicap of such individual with respect to which the State has determined that there is a need for additional compensation, and

"(ii) provided in the home of the foster care provider, and

"(B) are designated by the payor as compensation described in subparagraph (A).

"(2) Limitation based on number of individuals.—In the case of any foster home, difficulty of care payments for any period to which such payments relate shall not be excludable from gross income under subsection (a) to the extent such payments are made for more than—

"(A) 10 qualified foster individuals who have not attained age 19, and

"(B) 5 qualified foster individuals not described in subparagraph (A)."

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 1985.

SEC. 1708. EXTENSION OF RULES FOR SPOUSES OF INDIVIDUALS MISSING IN ACTION.

(a) EXTENSION OF PROVISIONS.—

(1) DEFINITION OF SURVIVING SPOUSE.—Subparagraph (B) of section 2(a)(3) (relating to special rule where deceased spouse was in missing status) is amended to read as follows:

"(B) except in the case of the combat zone designated for purposes of the Vietnam conflict, the date which is 2 years after the date designated under section 112 as the date of termination of combatant activities in that zone."

(2) INCOME TAXES OF MEMBERS OF ARMED FORCES ON DEATH.—The last sentence of section 692(b) (relating to individuals in missing status) is amended to read as follows: "Except in the case of the combat zone designated for purposes of the Vietnam conflict, the preceding sentence shall not cause subsection (a)(1) to apply for any taxable year beginning more than 2 years after the date designated under section 112 as the date of termination of combatant activities in a combat zone."

(3) JOINT RETURNS.—The last sentence of section 6013(f)(1) (relating to joint returns where an individual is in missing status) is amended by striking out "no such election may be made for any taxable year beginning after December 31, 1982" and inserting in lieu thereof "such election may be made for any taxable year while an individual is in missing status".

(4) POSTPONEMENT OF TIME FOR PERFORMING CERTAIN ACTS.—The last sentence of section 7508(b) (relating to application to spouse) is amended to read as follows: "Except in the case of the combat zone designated for purposes of the Vietnam conflict, the preceding sentence shall not cause this section to apply for any spouse for any taxable year beginning more than 2 years after the date designated under section 112 as the date of termination of combatant activities in a combat zone."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1982.

SEC. 1709. AMENDMENT TO THE REINDEER INDUSTRY ACT OF 1937.

(a) TAX EXEMPTION FOR REINDEER-RELATED INCOME.—Before the period at the end of the first sentence of section 8 of the Act of September 1, 1937 (50 Stat. 900, chapter 897), insert the following: ": Provided, That during the period of the trust, income derived directly from the sale of reindeer and reindeer products as provided in this Act shall be exempt from Federal income taxation".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect as if originally included in the provision of the Act of September 1, 1937, to which such amendment relates.

SEC. 1710. QUALITY CONTROL STUDIES.

Section 12301 of the Consolidated Omnibus Reconciliation Act of 1985 is amended—

(1) by striking out "of the enactment of this Act" in subsection (a)(3) and inserting in lieu thereof "the Secretary and the National Academy of Sciences enter into the contract required under paragraph (2)";

(2) by striking out "18 months after the date of the enactment of this Act" in subsection (c)(1) and inserting in lieu thereof "6 months after the date on which the results of both studies required under subsection (a)(3) have been reported".

SEC. 1711. ADOPTION ASSISTANCE AGREEMENTS UNDER ADOPTION ASSISTANCE PROGRAM; PAYMENT OF NONRECURRING EXPENSES RELATED TO ADOPTIONS OF CHILDREN WITH SPECIAL NEEDS.

(a) IN GENERAL.—Section 473(a) of the Social Security Act is amended—

(1) by redesignating paragraphs (2), (3), and (4) as paragraphs (3), (4), and (5), respectively, and

(2) by striking out all of paragraph (1) through "adopt a child who—" and inserting in lieu thereof the following:

"(1)(A) Each State having a plan approved under this part shall enter into adoption assistance agreements (as defined in section 475(3)) with the adoptive parents of children with special needs.

"(B) Under any adoption assistance agreement entered into by a State with parents who adopt a child with special needs, the State—

"(i) shall make payments of nonrecurring adoption expenses incurred by or on behalf of such parents in connection with the adoption of such child, directly through the State agency or through another public or nonprofit private agency, in amounts determined under paragraph (3), and

"(ii) in any case where the child meets the requirements of paragraph (2), may make adoption assistance payments to such parents, directly through the State agency or through another public or nonprofit private agency, in amounts so determined.

"(2) For purposes of paragraph (1)(B)(ii), a child meets the requirements of this paragraph if such child—

(b) DEFINITION AND PAYMENT OF NONRECURRING ADOPTION EXPENSES.—Section 473(a) of the Social Security Act, as amended by subsection (a) of this section, is further amended by adding at the end thereof the following new paragraph:

"(6)(A) For purposes of paragraph (1)(B)(i), the term 'nonrecurring adoption expenses' means reasonable and necessary adoption fees, court costs, attorney fees, and other expenses which are directly related to the legal adoption of a child with special needs and which are not incurred in violation of State or Federal law.

"(B) A State's payment of nonrecurring adoption expenses under an adoption assistance agreement shall be treated as an expenditure made for the proper and efficient administration of the State plan for purposes of section 474(a)(3)(B)."

(c) TECHNICAL AND CONFORMING AMENDMENTS.—

(1) The first sentence of section 470 of the Social Security Act is amended by striking out "foster care" and all that follows down through "title XVI)" and inserting in lieu thereof the following: "foster care and transitional independent living programs for children who otherwise would be eligible for assist-

ance under the State's plan approved under part A and adoption assistance for children with special needs".

(2) Paragraphs (1) and (11) of section 471(a) of such Act are each amended by striking out "adoption assistance payments" and inserting in lieu thereof "adoption assistance".

(3) Section 473(a)(3) of such Act, as redesignated by subsection (a)(1) of this section, is amended—

(A) by striking out "adoption assistance payments" in the first sentence and inserting in lieu thereof "payments to be made in any case under clauses (i) and (ii) of paragraph (1)(B)", and

(B) by inserting after "the adoption assistance payment" the first place it appears in the second sentence the following: "made under clause (ii) of paragraph (1)(B)".

(4) Section 473(a)(5) of such Act, as so redesignated, is amended by striking out ", pursuant to an interlocutory decree, shall be eligible for adoption assistance payments under this subsection," and inserting in lieu thereof "in accordance with applicable State and local law shall be eligible for such payments,".

(5) Section 473(b)(1)(A) of such Act is amended by striking out "subsection (a)(1)" and inserting in lieu thereof "subsection(a)(2)".

(6) Section 475(3) of such Act is amended by striking out clause (A) and inserting in lieu thereof the following: "(A) specifies the nature and amount of any payments, services, and assistance to be provided under such agreement, and".

(d) Effective Date.—The amendments made by this section shall apply only with respect to expenditures made after December 31, 1986.

TITLE XVIII—TECHNICAL CORRECTIONS

SEC. 1800. COORDINATION WITH OTHER TITLES.

For purposes of applying the amendments made by any title of this Act other than this title, the provisions of this title shall be treated as having been enacted immediately before the provisions of such other titles.

Subtitle A—Amendments Related to the Tax Reform Act of 1984

CHAPTER 1—AMENDMENTS RELATED TO TITLE I OF THE ACT

SEC. 1801. AMENDMENTS RELATED TO DEFERRAL OF CERTAIN TAX REDUCTIONS.

(a) Amendments Related to Section 12 of the Act.—

(1) Election out of transitional rules.—Paragraph (1) of section 12(c) of the Tax Reform Act of 1984 (relating to finance lease provisions) is amended by adding at the end thereof the following new sentence:

"The preceding sentence shall not apply to any property with respect to which an election is made under this sentence at such time after the date of the enactment of the Tax Reform Act of 1986 as the Secretary of the Treasury or his delegate may prescribe."

(2) TREATMENT OF CERTAIN FARM FINANCE LEASES.—

(A) IN GENERAL.—If—

(i) any partnership or grantor trust is the lessor under a specified agreement,

(ii) such partnership or grantor trust met the requirements of section 168(f)(8)(C)(i) of the Internal Revenue Code of 1954 (relating to special rules for finance leases) when the agreement was entered into, and

(iii) a person other than a C corporation became a partner in such partnership (or a beneficiary in such trust) before September 26, 1985,

then, for purposes of applying the revenue laws of the United States in respect to such agreement, the portion of the property allocable to partners (or beneficiaries) not described in clause (iii) shall be treated as if it were subject to a separate agreement and the portion of such property allocable to the partner or beneficiary described in clause (iii) shall be treated as if it were subject to a separate agreement.

(B) SPECIFIED AGREEMENT.—For purposes of subparagraph (A), the term "specified agreement" means an agreement to which subparagraph (B) of section 209(d) of the Tax Equity and Fiscal Responsibility Act of 1982 applies which is—

(i) an agreement dated as of December 20, 1982, as amended and restated as of February 1, 1983, involving approximately $8,734,000 of property at December 31, 1983,

(ii) an agreement dated as of December 15, 1983, as amended and restated as of January 3, 1984, involving approximately $13,199,000 of property at December 31, 1984, or

(iii) an agreement dated as of October 25, 1984, as amended and restated as of December 1, 1984, involving approximately $966,000 of property at December 31, 1984.

(b) AMENDMENT RELATED TO SECTION 26 OF THE ACT.—Paragraph (2) of section 4251(b) (relating to rate of tax on communications services) is amended by inserting "1985," after "1984," in the table contained in such section.

(c) AMENDMENTS RELATED TO SECTION 27 OF THE ACT.—

(1) Subsection (e) of section 5061 (relating to payment by electronic fund transfer of alcohol taxes) is amended by adding at the end thereof the following new paragraph:

"(3) CONTROLLED GROUPS.—

"(A) IN GENERAL.—In the case of a controlled group of corporations, all corporations which are component members of such group shall be treated as 1 taxpayer. For purposes of the preceding sentence, the term 'controlled group

of corporations' has the meaning given to such term by subsection (a) of section 1563, except that 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in such subsection.

"(B) Controlled groups which include nonincorporated persons.—Under regulations prescribed by the Secretary, principles similar to the principles of subparagraph (A) shall apply to a group of persons under common control where 1 or more of such persons is not a corporation."

(2) Paragraph (3) of section 5703(b) (relating to payment by electronic fund transfer of tobacco taxes) is amended by adding at the end thereof the following: "Rules similar to the rules of section 5061(e)(3) shall apply to the $5,000,000 amount specified in the preceding sentence."

(3) Paragraph (7) of section 27(b) of the Tax Reform Act of 1984 (relating to floor stocks tax on distilled spirits) is amended by adding at the end thereof the following new subparagraph:

"(F) Treatment of distilled spirits in foreign trade zones.—Notwithstanding the Act of June 18, 1934 (48 Stat. 998, 19 U.S.C. 81a) or any other provision of law, distilled spirits which are located in a foreign trade zone on October 1, 1985, shall be subject to the tax imposed by paragraph (1) and shall be treated for purposes of this subsection as held on such date for sale if—

"(i) internal revenue taxes have been determined, or customs duties liquidated, with respect to such distilled spirits before such date pursuant to a request made under the first proviso of section 3(a) of such Act, or

"(ii) such distilled spirits are held on such date under the supervision of customs pursuant to the second proviso of such section 3(a).

Under regulations prescribed by the Secretary, provisions similar to sections 5062 and 5064 of such Code shall apply to distilled spirits with respect to which tax is imposed by paragraph (1) by reason of this subparagraph."

SEC. 1802. AMENDMENTS RELATED TO TAX-EXEMPT ENTITY LEASING PROVISIONS.

(a) Amendments Relating to Section 31 of the Act.—

(1) Treatment of use in unrelated trade or business.—Subparagraph (D) of section 168(j)(3) (relating to exception where property used in unrelated trade or business) is amended by adding at the end thereof the following new sentence: "For purposes of subparagraph (B)(iii), any portion of a property so used shall not be treated as leased to a tax-exempt entity in a disqualified lease."

(2) Treatment of certain previously tax-exempt organizations.—

(A) Clause (i) of section 168(j)(4)(E) (relating to treatment of certain previously tax-exempt organizations) is amended—

(i) by striking out "any property of which such organization is the lessee" and inserting in lieu thereof

"any property (other than property held by such organization)", and

(ii) by striking out "first leased to" and inserting in lieu thereof "first used by".

(B) Subclause (I) of section 168(j)(4)(E)(ii) is amended by striking out "of which such organization is the lessee".

(C) Subclause (II) of section 168(j)(4)(E)(ii) is amended by striking out "is placed in service under the lease" and inserting in lieu thereof "is first used by the organization".

(D) Subparagraph (E) of section 168(j)(4) is amended by adding at the end thereof the following new clause:

"(iv) FIRST USED.—For purposes of this subparagraph, property shall be treated as first used by the organization—

"(I) when the property is first placed in service under a lease to such organization, or

"(II) in the case of property leased to (or held by) a partnership (or other pass-thru entity) in which the organization is a member, the later of when such property is first used by such partnership or pass-thru entity or when such organization is first a member of such partnership or pass-thru entity."

(E)(i) Paragraph (9) of section 168(j) is amended by redesignating subparagraph (E) as subparagraph (F) and by inserting after subparagraph (D) the following new subparagraph:

"(E) TREATMENT OF CERTAIN TAXABLE ENTITIES.—

"(i) IN GENERAL.—For purposes of this paragraph, except as otherwise provided in this subparagraph, any tax-exempt controlled entity shall be treated as a tax-exempt entity.

"(ii) ELECTION.—If a tax-exempt controlled entity makes an election under this clause—

"(I) such entity shall not be treated as a tax-exempt entity for purposes of this paragraph, and

"(II) any gain recognized by a tax-exempt entity on any disposition of an interest in such entity (and any dividend or interest received or accrued by a tax-exempt entity from such tax-exempt controlled entity) shall be treated as unrelated business taxable income for purposes of section 511.

Any such election shall be irrevocable and shall bind all tax-exempt entities holding interests in such tax-exempt controlled entity. For purposes of subclause (II), there shall only be taken into account dividends which are properly allocable to income of the tax-exempt controlled entity which was not subject to tax under this chapter.

"(iii) TAX-EXEMPT CONTROLLED ENTITY.—The term 'tax-exempt controlled entity' means any corporation (which is not a tax-exempt entity determined without regard to this subparagraph and paragraph (4)(E)) if 50 percent or more (by value) of the stock in such corporation is held (directly or through the application of sec-

tion 318 determined without regard to the 50-percent limitation contained in subsection (a)(2)(C) thereof) by 1 or more tax-exempt entities."

(ii)(I) Except as otherwise provided in this clause, the amendment made by clause (i) shall apply to property placed in service after September 27, 1985; except that such amendment shall not apply to any property acquired pursuant to a binding written contract in effect on such date (and at all times thereafter).

(II) If an election under this subclause is made with respect to any property, the amendment made by clause (i) shall apply to such property whether or not placed in service on or before September 27, 1985.

(F) Clause (i)(I) of section 31(g)(16)(C) of the Tax Reform Act of 1984 (defining exempt arbitrage profits) is amended by striking out "section 168(j)(4)(E)(i)(I)" and inserting in lieu thereof "section 168(j)(4)(E)(i)".

(G) Clause (i) of section 168(j)(4)(E) is amended by striking out "preceding sentence" and inserting in lieu thereof "preceding sentence and subparagraph (D)(ii)".

(3) REPEAL OF OVERLAPPING SECRETARIAL AUTHORITY.—Clause (iv) of section 168(j)(5)(C) (relating to property not subject to rapid obsolescence may be excluded) is hereby repealed.

(4) PARTNERSHIP RULES.—

(A) Paragraph (8) of section 168(j) (relating to tax-exempt use of property leased to partnerships, etc., determined at partner level) is amended by striking out "and paragraphs (4) and (5) of section 48(a)" in the matter preceding subparagraph (A).

(B) Paragraph (9) of section 168(j) (relating to treatment of property owned by partnerships, etc.) is amended—

(i) by striking out "and paragraphs (4) and (5) of section 48(a)" in subparagraph (A), and

(ii) by striking out "loss deduction" in subparagraph (B)(i) and inserting in lieu thereof "loss, deduction".

(C) Paragraph (5) of section 48(a) (relating to property used by governmental units or foreign persons or entities) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

"(D) SPECIAL RULES FOR PARTNERSHIPS, ETC.—For purposes of this paragraph and paragraph (4), rules similar to the rules of paragraphs (8) and (9) of section 168(j) shall apply."

(5) TREATMENT OF CERTAIN AIRCRAFT LEASED TO FOREIGN PERSONS.—

(A) Subsection (a) of section 47 (relating to certain dispositions, etc., of section 38 property) is amended by adding at the end thereof the following new paragraph:

"(9) AIRCRAFT LEASED TO FOREIGN PERSONS OR ENTITIES.—

"(A) IN GENERAL.—Any aircraft which was new section 38 property for the taxable year in which it was placed in service and which is used by any foreign person or entity (as defined in section 168(j)(4)(C)) under a qualified lease

(as defined in paragraph (7)(C)) entered into before January 1, 1990, shall not be treated as ceasing to be section 38 property by reason of such use until such aircraft has been so used for a period or periods exceeding 3 years in total.

"(B) RECAPTURE PERIOD EXTENDED.—For purposes of paragraphs (1) and (5)(B) of this subsection, any period during which there was use described in subparagraph (A) of an aircraft shall be disregarded."

(B) Clause (iii) of section 48(a)(5)(B) is hereby repealed.

(6) TREATMENT OF CERTAIN PARTNERSHIPS HAVING SECTION 593 ORGANIZATION AS MEMBER.—Paragraph (4) of section 46(e) is amended by adding at the end thereof the following new subparagraph:

"(D) SPECIAL RULES FOR PARTNERSHIPS, ETC.—For purposes of paragraph (1)(A), rules similar to the rules of paragraphs (8) and (9) of section 168(j) shall apply."

(7) TREATMENT OF CERTAIN PROPERTY HELD BY PARTNERSHIPS.—

(A) Paragraph (9) of section 168(j) (relating to treatment of property owned by partnerships, etc.) is amended by redesignating subparagraphs (D), (E), and (F) as subparagraphs (E), (F), and (G), respectively, and by inserting after subparagraph (C) the following new subparagraph:

"(D) DETERMINATION OF WHETHER PROPERTY USED IN UNRELATED TRADE OR BUSINESS.—For purposes of this subsection, in the case of any property which is owned by a partnership which has both a tax-exempt entity and a person who is not a tax-exempt entity as partners, the determination of whether such property is used in an unrelated trade or business of such an entity shall be made without regard to section 514."

(B) Subparagraph (E) of section 168(j)(9) (as redesignated by subparagraph (A)) is amended by striking out "and (C)" and inserting in lieu thereof "(C), and (D)".

(8) EXCEPTION FOR QUALIFIED REHABILITATED BUILDINGS LEASED TO SECTION 593 ORGANIZATIONS.—Paragraph (4) of section 46(e) (relating to special rules where section 593 organization is lessee) is amended by adding at the end thereof the following new subparagraph:

"(E) EXCEPTION FOR QUALIFIED REHABILITATED BUILDINGS LEASED TO SECTION 593 ORGANIZATIONS.—Subparagraph (A) shall not apply to qualified investment attributable to qualified rehabilitation expenditures for any portion of a building if such portion of the building would not be tax-exempt use property (as defined in section 168(j)) if the section 593 organization were a tax-exempt entity (as defined in section 168(j)(4))."

(9) CLERICAL AMENDMENTS.—

(A) Paragraph (4) of section 48(a) is amended—

(i) by striking out "514(c)" and inserting in lieu thereof "514(b)", and

(ii) by striking out "514(b)" and inserting in lieu thereof "514(a)".

(B) Subclause (I) of section 48(g)(2)(B)(vi) is amended by striking out "section 168(j)(3)" and inserting in lieu thereof "section 168(j)".

(C) Subparagraph (A) of section 7701(e)(4) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, the term 'related entity' has the same meaning as when used in section 168(j)."

(10) EFFECTIVE DATE PROVISIONS.—

(A) Subparagraph (B) of section 31(g)(3) of the Tax Reform Act of 1984 is amended by striking out "The amendments made by this section" and inserting in lieu thereof "Paragraph (9) of section 168(j) of the Internal Revenue Code of 1954 (as added by this section)".

(B) Effective with respect to property placed in service by the taxpayer after July 18, 1984, clause (ii) of section 31(g)(15)(D) of the Tax Reform Act of 1984 (relating to certain aircraft) is amended to read as follows:

"(ii) such aircraft is originally placed in service by such foreign person or entity (or its successor in interest under the contract) after May 23, 1983, and before January 1, 1986."

(C) Paragraph (4) of section 31(g) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subparagraph:

"(C) SPECIAL RULE FOR CREDIT UNIONS.—In the case of any property leased to a credit union pursuant to a written binding contract with an expiration date of December 31, 1984, which was entered into by such organization on August 23, 1984—

"(i) such credit union shall not be treated as an agency or instrumentality of the United States; and

"(ii) clause (ii) of subparagraph (A) shall be applied by substituting 'January 1, 1987' for 'January 1, 1985'."

(D)(i) Clause (ii) of section 31(g)(20)(B) of the Tax Reform Act of 1984 (defining substantial improvement) is amended by striking out subclauses (I) and (II) and inserting in lieu thereof the following:

"(I) by substituting 'property' for 'building' each place it appears therein,

"(II) by substituting '20 percent' for '25 percent' in clause (ii) thereof, and

"(III) without regard to clause (iii) thereof."

(ii) The amendment made by clause (i) shall not apply to any property if—

(I) on or before March 28, 1985, the taxpayer (or a predecessor in interest under the contract) or the tax-exempt entity entered into a written binding contract to acquire, construct, or rehabilitate the property, or

(II) the taxpayer or the tax-exempt entity began the construction, reconstruction, or rehabilitation of the property on or before March 28, 1985.

(E) Paragraph (4) of section 31(g) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subparagraphs:

"(D) SPECIAL RULE FOR GREENVILLE AUDITORIUM BOARD.—For purposes of this paragraph, significant official governmental action taken by the Greenville County Auditorium Board of Greenville, South Carolina, before May 23, 1983, shall be treated as significant official governmental action with respect to the coliseum facility subject to a binding contract to lease which was in effect on January 1, 1985.

"(E) TREATMENT OF CERTAIN HISTORIC STRUCTURES.—If—

"(i) On June 16, 1982, the legislative body of the local governmental unit adopted a bond ordinance to provide funds to renovate elevators in a deteriorating building owned by the local governmental unit and listed in the National Register, and

"(ii) the chief executive officer of the local governmental unit, in connection with the renovation of such building, made an application on June 1, 1983, to a State agency for a Federal historic preservation grant and made an application on June 17, 1983, to the Economic Development Administration of the United States Department of Commerce for a grant,

the requirements of clauses (i) and (ii) of subparagraph (A) shall be treated as met."

(F) Subparagraph (H) of section 31(g)(17) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new sentence: "In the case of Clemson University, the preceding sentence applies only to the Continuing Education Center and the component housing project."

(G) Subparagraph (L) of section 31(g)(17) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following:

"Property is described in this subparagraph if such property was leased to a tax-exempt entity pursuant to a lease recorded in the Registry of Deeds of Essex County, New Jersey, on May 7, 1984, and a deed of such property was recorded in the Registry of Deeds of Essex County, New Jersey, on May 7, 1985."

(b) AMENDMENTS RELATED TO SECTION 32 OF THE ACT.—

(1) Subsection (f) of section 168 (relating to special rules) is amended—

(A) by redesignating the paragraph (13) relating to motor vehicle operating leases as paragraph (14), and

(B) by redesignating paragraph (14) as paragraph (15).

(2) Subsection (c) of section 32 of the Tax Reform Act of 1984 is amended by striking out "section 168(f)(13)" and inserting in lieu thereof "section 168(f)(14)".

SEC. 1803. AMENDMENTS RELATED TO TREATMENT OF BONDS AND OTHER DEBT INSTRUMENTS.

(a) AMENDMENTS RELATED TO SECTION 41 OF THE ACT.—

(1) TREATMENT OF SHORT-TERM NONGOVERNMENT OBLIGATIONS.—

(A) Subsection (a) of section 1271 (relating to treatment of amounts received on retirement or sale or exchange of debt

instruments) is amended by adding at the end thereof the following new paragraph:

"(4) CERTAIN SHORT-TERM NONGOVERNMENT OBLIGATIONS.—

"(A) IN GENERAL.—On the sale or exchange of any short-term nongovernment obligation, any gain realized which does not exceed an amount equal to the ratable share of the original issue discount shall be treated as ordinary income.

"(B) SHORT-TERM NONGOVERNMENT OBLIGATION.—For purposes of this paragraph, the term 'short-term nongovernment obligation' means any obligation which—

"(i) has a fixed maturity date not more than 1 year from the date of the issue, and

"(ii) is not a short-term Government obligation (as defined in paragraph (3)(B) without regard to the last sentence thereof).

"(C) RATABLE SHARE.—For purposes of this paragraph, except as provided in subparagraph (D), the ratable share of the original issue discount is an amount which bears the same ratio to such discount as—

"(i) the number of days which the taxpayer held the obligation, bears to

"(ii) the number of days after the date of original issue and up to (and including) the date of its maturity.

"(D) ELECTION OF ACCRUAL ON BASIS OF CONSTANT INTEREST RATE.—At the election of the taxpayer with respect to any obligation, the ratable share of the original issue discount is the portion of the original issue discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

"(i) the yield to maturity based on the issue price of the obligation, and

"(ii) compounding daily.

Any election under this subparagraph, once made with respect to any obligation, shall be irrevocable."

(B) Paragraph (3) of section 1283(d) is amended by striking out "section 1271(a)(3)" and inserting in lieu thereof "paragraphs (3) and (4) of section 1271(a)".

(2) ELECTION OF ACCRUAL ON BASIS OF CONSTANT INTEREST RATE FOR SHORT-TERM GOVERNMENT OBLIGATIONS.—

(A) IN GENERAL.—Paragraph (3) of section 1271(a) (relating to certain short-term Government obligations) is amended by adding at the end thereof the following new subparagraph:

"(E) ELECTION OF ACCRUAL ON BASIS OF CONSTANT INTEREST RATE.—At the election of the taxpayer with respect to any obligation, the ratable share of the acquisition discount is the portion of the acquisition discount accruing while the taxpayer held the obligation determined (under regulations prescribed by the Secretary) on the basis of—

"(i) the taxpayer's yield to maturity based on the taxpayer's cost of acquiring the obligation, and

"(ii) compounding daily.

An election under this subparagraph, once made with respect to any obligation, shall be irrevocable."

(B) TECHNICAL AMENDMENT.—Subparagraph (D) of section 1271(a)(3) is amended by striking out "this paragraph" and inserting in lieu thereof "this paragraph, except as provided in subparagraph (E)".

(3) DEFINITION OF SHORT-TERM GOVERNMENT OBLIGATION.—Subparagraph (B) of section 1271(a)(3) (defining short-term Government obligation) is amended to read as follows:

"(B) SHORT-TERM GOVERNMENT OBLIGATION.—For purposes of this paragraph, the term 'short-term Government obligation' means any obligation of the United States or any of its possessions, or of a State or any political subdivision thereof, or of the District of Columbia, which has a fixed maturity date not more than 1 year from the date of issue. Such term does not include any tax-exempt obligation."

(4) DEDUCTION OF ORIGINAL ISSUE DISCOUNT ON SHORT-TERM OBLIGATIONS.—Paragraph (2) of section 163(e) (relating to original issue discount) is amended by adding at the end thereof the following new subparagraph:

"(C) SHORT-TERM OBLIGATIONS.—In the case of an obligor of a short-term obligation (as defined in section 1283(a)(1)(A)) who uses the cash receipts and disbursements method of accounting, the original issue discount (and any other interest payable) on such obligation shall be deductible only when paid."

(5) TREATMENT OF CERTAIN TRANSFERS OF MARKET DISCOUNT BONDS.—Paragraph (1) of section 1276(d) (relating to special rules) is amended by striking out "and" at the end of subparagraph (A) and by inserting after subparagraph (B) the following new subparagraph:

"(C) paragraph (3) of section 1245(b) shall be applied as if it did not contain a reference to section 351, and".

(6) TREATMENT OF BONDS ACQUIRED AT ORIGINAL ISSUE FOR PURPOSES OF MARKET DISCOUNT RULES.—Paragraph (1) of section 1278(a) (defining market discount bond) is amended by adding at the end thereof the following new subparagraph:

"(C) TREATMENT OF BONDS ACQUIRED AT ORIGINAL ISSUE.—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph or in regulations, the term 'market discount bond' shall not include any bond acquired by the taxpayer at its original issue.

"(ii) TREATMENT OF BONDS ACQUIRED FOR LESS THAN ISSUE PRICE.—Clause (i) shall not apply to any bond if—

"(I) the basis of the taxpayer in such bond is determined under section 1012, and

"(II) such basis is less than the issue price of such bond determined under subpart A of this part.

"(iii) BONDS ACQUIRED IN CERTAIN REORGANIZATIONS.—Clause (i) shall not apply to any bond issued

pursuant to a plan of reorganization (within the meaning of section 368(a)(1)) in exchange for another bond having market discount. Solely for purposes of section 1276, the preceding sentence shall not apply if such other bond was issued on or before July 18, 1984 (the date of the enactment of section 1276) and if the bond issued pursuant to such plan of reorganization has the same term and the same interest rate as such other bond had.

"(iv) TREATMENT OF CERTAIN TRANSFERRED BASIS PROPERTY.—For purposes of clause (i), if the adjusted basis of any bond in the hands of the taxpayer is determined by reference to the adjusted basis of such bond in the hands of a person who acquired such bond at its original issue, such bond shall be treated as acquired by the taxpayer at its original issue."

(7) TREATMENT OF CERTAIN STRIPPED BONDS OR STRIPPED COUPONS.—Paragraph (1) of section 1281(b) (relating to short-term obligations to which section applies) is amended by striking out "or" at the end of subparagraph (D), by striking out the period at the end of subparagraph (E) and inserting in lieu thereof ", or", and by adding at the end thereof the following new subparagraph:

"(F) is a stripped bond or stripped coupon held by the person who stripped the bond or coupon (or by any other person whose basis is determined by reference to the basis in the hands of such person)."

(8) ACCRUAL OF INTEREST PAYMENTS ON CERTAIN SHORT-TERM OBLIGATIONS.—

(A) Effective with respect to obligations acquired after September 27, 1985, subsection (a) of section 1281 (relating to current inclusion in income of discount on certain short-term obligations) is amended to read as follows:

"(a) GENERAL RULE.—In the case of any short-term obligation to which this section applies, for purposes of this title—

"(1) there shall be included in the gross income of the holder an amount equal to the sum of the daily portions of the acquisition discount for each day during the taxable year on which such holder held such obligation, and

"(2) any interest payable on the obligation (other than interest taken into account in determining the amount of the acquisition discount) shall be included in gross income as it accrues."

(B) Subsection (a) of section 1282 (relating to deferral of interest deduction allocable to accrued discount) is amended to read as follows:

"(a) GENERAL RULE.—Except as otherwise provided in this section, the net direct interest expense with respect to any short-term obligation shall be allowed as a deduction for the taxable year only to the extent such expense exceeds the sum of—

"(1) the daily portions of the acquisition discount for each day during the taxable year on which the taxpayer held such obligation, and

"(2) the amount of any interest payable on the obligation (other than interest taken into account in determining the

amount of the acquisition discount) which accrues during the taxable year while the taxpayer held such obligation (and is not included in the gross income of the taxpayer for such taxable year by reason of the taxpayer's method of accounting)."

(9) Treatment of transfers of land between related parties.—In the case of any sale or exchange before July 1, 1985, to which section 483(f) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of Public Law 99-121) applies, such section shall be treated as providing that the discount rate to be used for purposes of section 483(c)(1) of such Code shall be 6 percent, compounded semiannually.

(10) Clarification of treatment of debt instruments issued for publicly traded property.—Subparagraph (B) of section 1273(b)(3) (relating to debt instruments issued for property where there is public trading) is amended to read as follows:

"(B)(i) is issued for stock or securities which are traded on an established securities market, or

"(ii) to the extent provided in regulations, is issued for property (other than stock or securities) of a kind regularly traded on an established market,".

(11) Bond premiums amortized at constant rate, etc.—

(A) In general.—Paragraph (3) of section 171(b) (relating to amortizable bond premiums) is amended to read as follows:

"(3) Method of determination.—

"(A) In general.—Except as provided in regulations prescribed by the Secretary, the determinations required under paragraphs (1) and (2) shall be made on the basis of the taxpayer's yield to maturity determined by—

"(i) using the taxpayer's basis (for purposes of determining loss on sale or exchange) of the obligation, and

"(ii) compounding at the close of each accrual period (as defined in section 1272(a)(5)).

"(B) Special rule where earlier call date is used.—For purposes of subparagraph (A), if the amount payable on an earlier call date is used under paragraph (1)(B)(ii) in determining the amortizable bond premium attributable to the period before the earlier call date, such bond shall be treated as maturing on such date for the amount so payable and then reissued on such date for the amount so payable."

(B) Amortizable bond premium rules to apply to obligations issued by individuals, etc.—Subsection (d) of section 171 (defining bond) is amended by striking out "issued by any corporation and bearing interest (including any like obligation issued by a government or political subdivision thereof),".

(C) Effective date.—

(i) The amendments made by this paragraph shall apply to obligations issued after September 27, 1985.

(ii) In the case of a taxpayer with respect to whom an election is in effect on the date of the enactment of this Act under section 171(c) of the Internal Revenue Code of 1954, such election shall apply to obligations issued

after September 27, 1985, only if the taxpayer chooses (at such time and in such manner as may be prescribed by the Secretary of the Treasury or his delegate) to have such election apply with respect to such obligations.

(12) CLARIFICATION OF AMOUNT OF AMORTIZABLE BOND PREMIUM.—

(A) IN GENERAL.—Subsection (b) of section 171 (defining amortizable bond premium) is amended by adding at the end thereof the following new paragraph:

"(4) TREATMENT OF CERTAIN BONDS ACQUIRED IN EXCHANGE FOR OTHER PROPERTY.—

"(A) IN GENERAL.—If—

"(i) a bond is acquired by any person in exchange for other property, and

"(ii) the basis of such bond is determined (in whole or in part) by reference to the basis of such other property,

for purposes of applying this subsection to such bond while held by such person, the basis of such bond shall not exceed its fair market value immediately after the exchange. A similar rule shall apply in the case of such bond while held by any other person whose basis is determined (in whole or in part) by reference to the basis in the hands of the person referred to in clause (i).

"(B) SPECIAL RULE WHERE BOND EXCHANGED IN REORGANIZATION.—Subparagraph (A) shall not apply to an exchange by the taxpayer of a bond for another bond if such exchange is a part of a reorganization (as defined in section 368). If any portion of the basis of the taxpayer in a bond transferred in such an exchange is not taken into account in determining bond premium by reason of this paragraph, such portion shall not be taken into account in determining the amount of bond premium on any bond received in the exchange."

(B) EFFECTIVE DATE.—The amendment made by subparagraph (A) shall apply to exchanges after May 6, 1986.

(13) SPECIAL RULE FOR BONDS WITH PARTIAL PRINCIPAL PAYMENTS.—

(A) TREATMENT OF ACCRUED MARKET DISCOUNT.—

(i) Subsection (a) of section 1276 (relating to disposition gain representing accrued market dicount treated as ordinary income) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) TREATMENT OF PARTIAL PRINCIPAL PAYMENTS.—

"(A) IN GENERAL.—Any partial principal payment on a market discount bond shall be included in gross income as ordinary income to the extent such payment does not exceed the accrued market discount on such bond.

"(B) ADJUSTMENT.—If subparagraph (A) applies to any partial principal payment on any market discount bond, for purposes of applying this section to any disposition of (or subsequent partial principal payment on) such bond, the amount of accrued market discount shall be reduced by the

amount of such partial principal payment included in gross income under subparagraph (A).”

(ii) Paragraph (4) of section 1276(a) (as redesignated by subparagraph (A)) is amended by striking out “under paragraph (1)” and inserting in lieu thereof “under paragraph (1) or (3)”.

(iii) Subsection (b) of section 1276 is amended by adding at the end thereof the following new paragraph:

“(3) SPECIAL RULE WHERE PARTIAL PRINCIPAL PAYMENTS.—In the case of a bond the principal of which may be paid in 2 or more payments, the amount of accrued market discount shall be determined under regulations prescribed by the Secretary.”

(B) COORDINATION WITH TAX TREATMENT OF STRIPPED BONDS.—

(i) Paragraph (1) of section 1286(b) (relating to tax treatment of person stripping bond) is amended to read as follows:

“(1) such person shall include in gross income an amount equal to the sum of—

“(A) the interest accrued on such bond while held by such person and before the time such coupon or bond was disposed of (to the extent such interest has not theretofore been included in such person's gross income), and

“(B) the accrued market discount on such bond determined as of the time such coupon or bond was disposed of (to the extent such discount has not theretofore been included in such person's gross income),”.

(ii) Paragraph (2) of section 1286(b) is amended by striking out “the amount of the accrued interest described in paragraph (1)” and inserting in lieu thereof “the amount included in gross income under paragraph (1)”.

(C) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to obligations acquired after the date of the enactment of this Act.

(14) CLERICAL AMENDMENTS.—

(A) Subparagraph (A) of section 1274(c)(4) is amended by striking out “FOR LESS THAN $1,000,000” in the subparagraph heading and inserting in lieu thereof “FOR $1,000,000 OR LESS”.

(B) Paragraph (1) of section 483(d) is amended by striking out “any debt instrument to which section 1272 applies” and inserting in lieu thereof “any debt instrument for which an issue price is determined under section 1273(b) (other than paragraph (4) thereof) or section 1274”.

(C) Clause (iii) of section 6049(b)(5)(B) is amended by striking out “section 1232(b)(1)” and inserting in lieu thereof “section 1273(a)”.

(b) AMENDMENTS RELATED TO SECTION 44 OF THE ACT.—

(1) CLARIFICATION OF TRANSITIONAL RULE FOR PURPOSES OF IMPUTED INTEREST RULES.—Paragraph (4) of section 44(b) of the Tax Reform Act of 1984 (relating to special rules for sales

before July 1, 1985), as added by section 2 of Public Law 98-612, is amended—

(A) by striking out "before July 1, 1985" in subparagraph (A) and inserting in lieu thereof "after December 31, 1984, and before July 1, 1985",

(B) by striking out "BEFORE JULY 1, 1985" in the paragraph heading and inserting in lieu thereof "AFTER DECEMBER 31, 1984, AND BEFORE JULY 1, 1985", and

(C) by adding at the end thereof the following new subparagraph:

"(G) CLARIFICATION OF APPLICATION OF THIS PARAGRAPH, ETC.—This paragraph and paragraphs (5), (6), and (7) shall apply only in the case of sales or exchanges to which section 1274 or 483 of the Internal Revenue Code of 1954 (as amended by section 41) applies."

(2) CLARIFICATION OF INTEREST ACCRUAL, ETC.—Subparagraph (A) of section 44(b)(3) of the Tax Reform Act of 1984 is amended by striking out "and before January 1, 1985," each place it appears.

(3) EXCEPTION FOR BINDING CONTRACTS.—Subparagraph (B) of section 44(b)(3) of the Tax Reform Act of 1984 is amended to read as follows:

"(B) EXCEPTION FOR BINDING CONTRACTS.—

"(i) Subparagraph (A)(i)(I) shall not apply to any sale or exchange pursuant to a written contract which was binding on March 1, 1984, and at all times thereafter before the sale or exchange.

"(ii) Subparagraph (A)(i)(II) shall not apply to any sale or exchange pursuant to a written contract which was binding on June 8, 1984, and at all times thereafter before the sale or exchange."

(4) CLERICAL AMENDMENT.—Clause (ii) of section 44(b)(6)(B) of the Tax Reform Act of 1984 (as added by section 2 of Public Law 98-612) is amended by striking out "greater than" and inserting in lieu thereof "not greater than".

(5) CLARIFICATION OF EFFECTIVE DATE FOR REPEAL OF CAPITAL ASSET REQUIREMENT.—Subsection (g) of section 44 of the Tax Reform Act of 1984 is amended by striking out "before December 31, 1984" and inserting in lieu thereof "on or before December 31, 1984".

SEC. 1804. AMENDMENTS RELATED TO CORPORATE PROVISIONS.

(a) AMENDMENT RELATED TO SECTION 51 OF THE ACT.—Subsection (a) of section 246A (relating to dividends received deduction reduced where portfolio stock is debt financed) is amended—

(1) by striking out "or 245" and inserting in lieu thereof "or 245(a)", and

(2) by adding at the end thereof the following new sentence: "The preceding sentence shall be applied before any determination of a ratio under paragraph (1) or (2) of section 245(a)."

(b) AMENDMENTS RELATED TO SECTION 53 AND SECTION 54 OF THE ACT.—

(1) AMENDMENTS TO SECTION 246.—

(A) Subparagraph (A) of section 246(c)(1) (relating to exclusion of certain dividends) is amended to read as follows:

"(A) which is held by the taxpayer for 45 days or less, or".

(B) Paragraph (4) of section 246(c) (relating to holding period reduced for periods where risk of loss diminished) is amended by striking out "determined under paragraph (3)" and inserting in lieu thereof "determined for purposes of this subsection".

(C) The amendments made by this paragraph shall apply to stock acquired after March 1, 1986.

(2) EFFECTIVE DATE FOR RELATED PERSON PROVISIONS.—Paragraph (3) of section 53(e) of the Tax Reform Act of 1984 (relating to effective date for related person provisions) is amended to read as follows:

"(3) RELATED PERSON PROVISIONS.—

"(A) IN GENERAL.—Except as otherwise provided in subparagraph (B), the amendment made by subsection (c) shall take effect on July 18, 1984.

"(B) SPECIAL RULE FOR PURPOSES OF SECTION 265(2).—The amendment made by subsection (c) insofar as it relates to section 265(2) of the Internal Revenue Code of 1954 shall apply to—

"(i) term loans made after July 18, 1984, and

"(ii) demand loans outstanding after July 18, 1984 (other than any loan outstanding on July 18, 1984, and repaid before September 18, 1984).

"(C) TREATMENT OF RENEGOTIATIONS, ETC.—For purposes of this paragraph, any loan renegotiated, extended, or revised after July 18, 1984, shall be treated as a loan made after such date.

"(D) DEFINITION OF TERM AND DEMAND LOANS.—For purposes of this paragraph, the terms 'demand loan' and 'term loan' have the respective meanings given such terms by paragraphs (5) and (6) of section 7872(f) of the Internal Revenue Code of 1954, except that the second sentence of such paragraph (5) shall not apply."

(3) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS BEFORE JANUARY 1, 1988.—Paragraph (3) of section 54 of the Tax Reform Act of 1984 (relating to exceptions for distributions before January 1, 1985, to 80-percent corporate shareholders) is amended by adding at the end thereof the following new subparagraph:

"(D) SPECIAL RULE FOR CERTAIN DISTRIBUTIONS BEFORE JANUARY 1, 1988.—

"(i) IN GENERAL.—In the case of a transaction to which this subparagraph applies, subparagraph (A) shall be applied by substituting '1988' for '1985' and the amendments made by subtitle D of title VI shall not apply.

"(ii) TRANSACTION TO WHICH SUBPARAGRAPH APPLIES.—This subparagraph applies to a transaction in which a Delaware corporation which was incorporated on May 31, 1927, and which was acquired by the trans-

feree on December 9, 1968, transfers to the transferee stock in a corporation—

"(I) with respect to which such Delaware corporation is a 100-percent corporate shareholder, and

"(II) which is a Tennessee corporation which was incorporated on October 5, 1981, and which is a successor to an Indiana corporation which was incorporated on June 28, 1946, and acquired by the transferee on December 9, 1968."

(c) Amendments Related to Section 55 of the Act.—

(1) Clause (ii) of section 852(b)(4)(B) (relating to losses attributable to exempt-interest dividend) is amended by striking out "for less than 31 days" and inserting in lieu thereof "for 6 months or less".

(2) Subparagraph (C) of section 852(b)(4) (relating to determination of holding periods) is amended to read as follows:

"(C) Determination of holding periods.—For purposes of this paragraph, the rules of paragraphs (3) and (4) of section 246(c) shall apply in determining the period for which the taxpayer has held any share of stock; except that '6 months' shall be substituted for each number of days specified in subparagraph (B) of section 246(c)(3)."

(3) Subparagraph (D) of section 852(b)(4) (relating to losses incurred under a periodic liquidation plan) is amended by striking out "subparagraph (A)" and inserting in lieu thereof "subparagraphs (A) and (B)".

(4) Paragraph (4) of section 852(b) is amended by adding at the end thereof the following new subparagraph:

"(E) Authority to shorten required holding period.—In the case of a regulated investment company which regularly distributes at least 90 percent of its net tax-exempt interest, the Secretary may by regulations prescribe that subparagraph (B) (and subparagraph (C) to the extent it relates to subparagraph (B)) shall be applied on the basis of a holding period requirement shorter than 6 months; except that such shorter holding period requirement shall not be shorter than the greater of 31 days or the period between regular distributions of exempt-interest dividends."

(5) The paragraph heading for paragraph (4) of section 852(b) is amended by striking out "LESS THAN 31 DAYS" and inserting in lieu thereof "6 MONTHS OR LESS".

(6) The amendments made by this subsection shall apply to stock with respect to which the taxpayer's holding period begins after March 28, 1985.

(d) Amendment Related to Section 58 of the Act.—

(1) In general.—Paragraph (1) of section 562(b) (relating to distributions in liquidation) is amended by adding at the end thereof the following new sentence: "Except to the extent provided in regulations, the preceding sentence shall not apply in the case of any mere holding or investment company which is not a regulated investment company."

(2) Effective date.—The amendment made by paragraph (1) shall apply to distributions after September 27, 1985.

(e) AMENDMENTS RELATED TO SECTION 60 OF THE ACT.—

(1) TREATMENT OF CERTAIN REDEMPTION AND LIQUIDATION RIGHTS.—Subparagraph (C) of section 1504(a)(4) (relating to certain preferred stock not treated as stock) is amended to read as follows:

"(C) has redemption and liquidation rights which do not exceed the issue price of such stock (except for a reasonable redemption or liquidation premium), and".

(2) TREATMENT OF CERTAIN CORPORATIONS AFFILIATED ON JUNE 22, 1984.—Paragraph (2) of section 60(b) of the Tax Reform Act of 1984 (relating to special rule for corporations affiliated on June 22, 1984) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall cease to apply as of the first day after June 22, 1984, on which such corporation does not qualify as a member of such group under section 1504(a) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of this Act)."

(3) TREATMENT OF CERTAIN SELL-DOWNS AFTER JUNE 22, 1984.—Paragraph (3) of section 60(b) of the Tax Reform Act of 1984 (relating to special rule not to apply to certain sell-downs after June 22, 1984) is amended to read as follows:

"(3) SPECIAL RULE NOT TO APPLY TO CERTAIN SELL-DOWNS AFTER JUNE 22, 1984.—If—

"(A) the requirements of paragraph (2) are satisfied with respect to a corporation,

"(B) more than a de minimis amount of the stock of such corporation—

"(i) is sold or exchanged (including in a redemption), or

"(ii) is issued,

after June 22, 1984 (other than in the ordinary course of business), and

"(C) the requirements of the amendment made by subsection (a) are not satisfied after such sale, exchange, or issuance,

then the amendment made by subsection (a) shall apply for purposes of determining whether such corporation continues to be a member of the group. The preceding sentence shall not apply to any transaction if such transaction does not reduce the percentage of the fair market value of the stock of the corporation referred to in the preceding sentence held by members of the group determined without regard to this paragraph."

(4) TREATMENT OF CERTAIN CORPORATIONS AFFILIATED ON JUNE 22, 1984, ETC.—Subsection (b) of section 60 of the Tax Reform Act of 1984 is amended by striking out paragraph (5) and inserting in lieu thereof the following new paragraphs:

"(5) NATIVE CORPORATIONS.—

"(A) In the case of a Native Corporation established under the Alaska Native Claims Settlement Act (43 U.S.C. 1601 et seq.), or a corporation all of whose stock is owned directly by such a corporation, during any taxable year (beginning after the effective date of these amendments and before 1992), or any part thereof, in which the Native Cor-

poration is subject to the provisions of section 7(h)(1) of such Act (43 U.S.C. 1606(h)(1))—

"(i) the amendment made by subsection (a) shall not apply, and

"(ii) the requirements for affiliation under section 1504(a) of the Internal Revenue Code of 1986 before the amendment made by subsection (a) shall be applied solely according to the provisions expressly contained therein, without regard to escrow arrangements, redemption rights, or similar provisions.

"(B) Except as provided in subparagraph (C), during the period described in subparagraph (A), no provision of the Internal Revenue Code of 1986 (including sections 269 and 482) or principle of law shall apply to deny the benefit or use of losses incurred or credits earned by a corporation described in subparagraph (A) to the affiliated group of which the Native Corporation is the common parent.

"(C) Losses incurred or credits earned by a corporation described in subparagraph (A) shall be subject to the general consolidated return regulations, including the provisions relating to separate return limitation years, and to sections 382 and 383 of the Internal Revenue Code of 1986.

"(D) Losses incurred and credits earned by a corporation which is affiliated with a corporation described in subparagraph (A) shall be treated as having been incurred or earned in a separate return limitation year, unless the corporation incurring the losses or earning the credits satisfies the affiliation requirements of section 1504(a) without application of subparagraph (A).

"(6) TREATMENT OF CERTAIN CORPORATIONS AFFILIATED ON JUNE 22, 1984.—In the case of an affiliated group which—

"(A) has as its common parent a Minnesota corporation incorporated on April 23, 1940, and

"(B) has a member which is a New York corporation incorporated on November 13, 1969,

for purposes of determining whether such New York corporation continues to be a member of such group, paragraph (2) shall be applied by substituting for 'January 1, 1988,' the earlier of January 1, 1994, or the date on which the voting power of the preferred stock in such New York corporation terminates.

"(7) ELECTION TO HAVE AMENDMENTS APPLY FOR YEARS BEGINNING AFTER 1983.—If the common parent of any group makes an election under this paragraph, notwithstanding any other provision of this subsection, the amendments made by subsection (a) shall apply to such group for taxable years beginning after December 31, 1983. Any such election, once made, shall be irrevocable.

"(8) TREATMENT OF CERTAIN AFFILIATED GROUPS.—If—

"(A) a corporation (hereinafter in this paragraph referred to as the 'parent') was incorporated in 1968 and filed consolidated returns as the parent of an affiliated group for each of its taxable years ending after 1969 and before 1985,

"(B) another corporation (hereinafter in this paragraph referred to as the 'subsidiary') became a member of the parent's affiliated group in 1978 by reason of a recapitalization pursuant to which the parent increased its voting interest in the subsidiary from not less than 56 percent to not less than 85 percent, and

"(C) such subsidiary is engaged (or was on September 27, 1985, engaged) in manufacturing and distributing a broad line of business systems and related supplies for binding, laminating, shredding, graphics, and providing secure identification,

then, for purposes of determining whether such subsidiary corporation is a member of the parent's affiliated group under section 1504(a) of the Internal Revenue Code of 1954 (as amended by subsection (a)), paragraph (2)(B) of such section 1504(a) shall be applied by substituting '55 percent' for '80 percent'.

"(9) TREATMENT OF CERTAIN CORPORATIONS AFFILIATED DURING 1971.— In the case of a group of corporations which filed a consolidated Federal income tax return for the taxable year beginning during 1971 and which—

"(A) included as a common parent on December 31, 1971, a Delaware corporation incorporated on August 26, 1969, and

"(B) included as a member thereof a Delaware corporation incorporated on November 8, 1971,

for taxable years beginning after December 31, 1970, and ending before January 1, 1988, the requirements for affiliation for each member of such group under section 1504(a) of the Internal Revenue Code of 1954 (before the amendment made by subsection (a)) shall be limited solely to the provisions expressly contained therein and by reference to stock issued under State law as common or preferred stock. During the period described in the preceding sentence, no provision of the Internal Revenue Code of 1986 (including sections 269 and 482) or principle of law, except the general consolidated return regulations (including the privisions relating to separate return limitation years) and sections 382 and 383 of such Code, shall apply to deny the benefit or use of losses incurred or credits earned by members of such group."

(5) TREATMENT OF CERTAIN SELL-DOWNS.—Paragraph (4) of section 60(b) of the Tax Reform Act of 1984 (relating to exception for certain sell-downs) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, if there is a letter of intent between a corporation and a securities underwriter entered into on or before June 22, 1984, and the subsequent issuance or sale is effected pursuant to a registration statement filed with the Securities and Exchange Commission, such stock shall be treated as issued or sold pursuant to a registration statement filed with the Securities and Exchange Commission on or before June 22, 1984."

(6) AMENDMENT OF SECTION 332.—

(A) IN GENERAL.—Paragraph (1) of section 332(b) (relating to liquidations to which section applies) is amended to read as follows:

"(1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) meeting the requirements of section 1504(a)(2); and either".

(B) Effective date.—

(i) In general.—Except as provided in clause (iii), the amendment made by subparagraph (A) shall apply with respect to plans of complete liquidation adopted after March 28, 1985.

(ii) Certain distributions made after December 31, 1984.—Except as provided in clause (iii), the amendment made by subparagraph (A) shall also apply with respect to plans of complete liquidations adopted on or before March 28, 1985, pursuant to which any distribution is made in a taxable year beginning after December 31, 1984 (December 31, 1983, in the case of an affiliated group to which an election under section 60(b)(7) of the Tax Reform Act of 1984 applies), but only if the liquidating corporation and any corporation which receives a distribution in complete liquidation of such corporation are members of an affiliated group of corporations filing a consolidated return for the taxable year which includes the date of the distribution.

(iii) Transitional rule for affiliated groups.—The amendment made by subparagraph (A) shall not apply with respect to plans of complete liquidation if the liquidating corporation is a member of an affiliated group of corporations under section 60(b) (2), (5), (6), or (8) of the Tax Reform Act of 1984, for all taxable years which include the date of any distribution pursuant to such plan.

(7) Amendment of section 337.—

(A) In general.—Subparagraph (B) of section 337(c)(3) (defining distributee corporation) is amended to read as follows:

"(B) Distributee corporation.—For purposes of subparagraph (A), the term 'distributee corporation' means any corporation which receives a distribution to which section 332 applies in a complete liquidation of the selling corporation. Such term also includes any other corporation which receives a distribution to which section 332 applies in a complete liquidation of a corporation which is a distributee corporation under the preceding sentence or prior application of this sentence."

(B) Effective date.—The amendment made by subparagraph (A) shall apply in the case of plans of complete liquidation pursuant to which any distribution is made in a taxable year beginning after December 31, 1984 (December 31, 1983, in the case of an affiliated group to which an election under section 60(b)(7) of the Tax Reform Act of 1984 applies).

(8) Amendment of section 338.—

(A) IN GENERAL.—Paragraph (3) of section 338(d) (defining qualified stock purchase) is amended to read as follows:

"(3) QUALIFIED STOCK PURCHASE.—The term 'qualified stock purchase' means any transaction or series of transactions in which stock (meeting the requirements of section 1504(a)(2)) of 1 corporation is acquired by another corporation by purchase during the 12-month acquisition period."

(B) EFFECTIVE DATE.—The amendment made by subparagraph (A) shall apply in cases where the 12-month acquisition period (as defined in section 338(h)(1) of the Internal Revenue Code of 1954) begins after December 31, 1985.

(9) TREATMENT OF CERTAIN CORPORATION ORGANIZED ON FEBRUARY 22, 1983.—In the case of a Rhode Island corporation which was organized on February 22, 1983, and which on February 25, 1983—

(A) purchased the stock of another corporation,

(B) filed an election under section 338(g) of the Internal Revenue Code of 1986 with respect to such purchase, and

(C) merged into the acquired corporation, such purchase of stock shall be considered as made by the acquiring corporation, such election shall be valid, and the acquiring corporation shall be considered a purchasing corporation for purposes of section 338 of such Code without regard to the duration of the existence of the acquiring corporation.

(10) TREATMENT OF FORMER DISC'S.—Paragraph (7) of section 1504(b) (defining includible corporation) is amended to read as follows:

"(7) A DISC (as defined in section 992(a)(1)), or any other corporation which has accumulated DISC income which is derived after December 31, 1984."

(f) AMENDMENTS RELATED TO SECTION 61 OF THE ACT.—

(1) TREATMENT OF DISTRIBUTIONS OF APPRECIATED PROPERTY.—

(A) Subsection (b) of section 312 (relating to effect on earnings and profits) is amended to read as follows:

"(b) DISTRIBUTIONS OF APPRECIATED PROPERTY.—On the distribution by a corporation, with respect to its stock, of any property the fair market value of which exceeds the adjusted basis thereof—

"(1) the earnings and profits of the corporation shall be increased by the amount of such excess, and

"(2) subsection (a)(3) shall be applied by substituting 'fair market value' for 'adjusted basis'.

For purposes of this subsection and subsection (a), the adjusted basis of any property is its adjusted basis as determined for purposes of computing earnings and profits."

(B) Subsection (c) of section 312 is amended by inserting "and" at the end of paragraph (1), by striking out ", and" at the end of paragraph (2) and inserting in lieu thereof a period, and by striking out paragraph (3).

(C) The subsection heading for subsection (c) of section 312 is amended by striking out ", ETC".

(D) Subsection (n) of section 312 is amended by striking out paragraph (4) and by redesignating paragraphs (5), (6), *(7), (8), and (9) as paragraphs (4), (5), (6), (7), and (8), respectively.*

(E) Paragraph (8) of section 312(n) (as redesignated by subparagraph (D)) is amended by striking out "subsection (k)(4)" and all that follows and inserting in lieu thereof the following:

"subsection (k)(4)—

"(A) paragraphs (4) and (6) shall apply only in the case of taxable years beginning after December 31, 1985, and

"(B) paragraph (5) shall apply only in the case of taxable years beginning after December 31, 1987."

(F) Any reference in subsection (e) of section 61 of the Tax Reform Act of 1984 to a paragraph of section 312(n) of the Internal Revenue Code of 1954 shall be treated as a reference to such paragraph as in effect before its redesignation by subparagraph (D).

(2) CLERICAL AMENDMENTS.—

(A) Subsection (a) of section 1275 is amended—

(i) by redesignating the paragraph added by section 61 of the Tax Reform Act of 1984 as paragraph (5), and

(ii) by striking out "TO CORPORATIONS" in the heading of such paragraph and inserting in lieu thereof "BY CORPORATIONS".

(B) Paragraph (3) of section 301(f) is amended by striking out "this section" and inserting in lieu thereof "this subsection".

(3) EFFECTIVE DATE FOR TREATMENT OF REDEMPTIONS.—Paragraph (7) of section 312(n) of the Internal Revenue Code of 1954 (as redesignated by paragraph (1)(D) of this subsection), and the amendments made by section 61(a)(2) of the Tax Reform Act of 1984, shall apply to distributions in taxable years beginning after September 30, 1984.

(g) AMENDMENTS RELATED TO SECTION 63 OF THE ACT.—

(1) IN GENERAL.—Section 361 (relating to nonrecognition of gain or loss to corporations) is amended to read as follows:

"SEC. 361. NONRECOGNITION OF GAIN OR LOSS TO TRANSFEROR CORPORATION; OTHER TREATMENT OF TRANSFEROR CORPORATION; ETC.

"(a) GENERAL RULE.—No gain or loss shall be recognized to a transferor corporation which is a party to a reorganization on any exchange of property pursuant to the plan of reorganization.

"(b) OTHER TREATMENT OF TRANSFEROR CORPORATION.—In the case of a transferor corporation which is a party to a reorganization—

"(1) sections 336 and 337 shall not apply with respect to any liquidation of such corporation pursuant to the plan of reorganization,

"(2) the basis of the property (other than stock and securities described in paragraph (3)) received by the corporation pursuant to such plan of reorganization shall be the same as it would be in the hands of the transferor of such property, adjusted by the amount of gain or loss recognized to such transferor on such transfer, and

"(3) no gain or loss shall be recognized by such corporation on any disposition (pursuant to the plan of reorganization) of stock or securities which were received pursuant to such plan and which are in another corporation which is a party to such reorganization.

For purposes of paragraph (3), if the transferor corporation is merged, consolidated, or liquidated pursuant to the plan of reorganization, or if a transaction meets the requirements of section 368(a)(1)(C) pursuant to a waiver granted by the Secretary under section 368(a)(2)(G)(ii), any distribution of such stock or securities by the transferor corporation to its creditors in connection with such transaction shall be treated as pursuant to such plan of reorganization.

"(c) Treatment of Distributions of Appreciated Property.—Notwithstanding any other provision of this subtitle, gain shall be recognized on the distribution of property (other than property permitted by section 354, 355, or 356 to be received without the recognition of gain) pursuant to a plan of reorganization in the same manner as if such property had been sold to the distributee at its fair market value."

(2) Clarification of transfers to creditors.—Section 368(a)(2)(G)(i) (relating to distribution requirement) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, if the acquired corporation is liquidated pursuant to the plan of reorganization, any distribution to its creditors in connection with such liquidation shall be treated as pursuant to the plan of reorganization."

(3) Conforming amendment.—The table of sections for subpart C of part III of subchapter C of chapter 1 is amended by striking out the item relating to section 361 and inserting in lieu thereof the following:

"Sec. 361. Nonrecognition of gain or loss to transferor corporation; other treatment of transferor corporation; etc."

(4) Effective date.—The amendments made by this subsection shall apply to plans of reorganizations adopted after the date of the enactment of this Act.

(h) Amendments Related to Section 64 of the Act.—

(1) Subsection (c) of section 368 (defining control) is amended to read as follows:

"(c) Control Defined.—For purposes of part I (other than section 304), part II, this part, and part V, the term 'control' means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation."

(2) Paragraph (2) of section 368(a) is amended by adding at the end thereof the following new subparagraph:

"(H) Special rule for determining whether certain transactions are qualified under paragraph (1)(D).—In the case of any transaction with respect to which the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met, for purposes of determining whether such transaction qualifies under subparagraph (D) of paragraph (1), the

term 'control' has the meaning given to such term by section 304(c)."

(3) Section 368(a)(2) is amended by inserting "(other than for purposes of subparagraph (C))" in subparagraph (A) after "subchapter".

(i) AMENDMENTS RELATED TO SECTION 65 OF THE ACT.—

(1) IN GENERAL.—Subsection (a) of section 341 (relating to collapsible corporations) is amended by striking out "held for more than 6 months".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply with respect to sales, exchanges, and distributions after September 27, 1985.

(j) AMENDMENTS RELATED TO SECTION 67 OF THE ACT.—

(1) EXEMPTION FOR SMALL BUSINESS CORPORATIONS, ETC.—Subsection (b) of section 280G (defining excess parachute payment) is amended by adding at the end thereof the following new paragraph:

"(5) EXEMPTION FOR SMALL BUSINESS CORPORATIONS, ETC.—

"(A) IN GENERAL.—Notwithstanding paragraph (2), the term 'parachute payment' does not include—

"(i) any payment to a disqualified individual with respect to a corporation which (immediately before the change described in paragraph (2)(A)(i)) was a small business corporation (as defined in section 1361(b)), and

"(ii) any payment to a disqualified individual with respect to a corporation (other than a corporation described in clause (i)) if—

"(I) immediately before the change described in paragraph (2)(A)(i), no stock in such corporation was readily tradeable on an established securities market or otherwise, and

"(II) the shareholder approval requirements of subparagraph (B) are met with respect to such payment.

The Secretary may, by regulations, prescribe that the requirements of subclause (I) of clause (ii) are not met where a substantial portion of the assets of any entity consists (directly or indirectly) of stock in such corporation and interests in such other entity are readily tradeable on an established securities market, or otherwise.

"(B) SHAREHOLDER APPROVAL REQUIREMENTS.—The shareholder approval requirements of this subparagraph are met with respect to any payment if—

"(i) such payment was approved by a vote of the persons who owned, immediately before the change described in paragraph (2)(A)(i), more than 75 percent of the voting power of all outstanding stock of the corporation, and

"(ii) there was adequate disclosure to shareholders of all material facts concerning all payments which (but for this paragraph) would be parachute payments with respect to a disqualified individual."

(2) Treatment of reasonable compensation.—Paragraph (4) of section 280G(b) (relating to excess parachute payments reduced to extent taxpayer establishes reasonable compensation) is amended to read as follows:

"(4) Treatment of amounts which taxpayer establishes as reasonable compensation.—In the case of any payment described in paragraph (2)(A)—

> *"(A) the amount treated as a parachute payment shall not include the portion of such payment which the taxpayer establishes by clear and convincing evidence is reasonable compensation for personal services to be rendered on or after the date of the change described in paragraph (2)(A)(i), and*
>
> *"(B) the amount treated as an excess parachute payment shall be reduced by the portion of such payment which the taxpayer establishes by clear and convincing evidence is reasonable compensation for personal services actually rendered before the date of the change described in paragraph (2)(A)(i).*

For purposes of subparagraph (B), reasonable compensation for services actually rendered before the date of the change described in paragraph (2)(A)(i) shall be first offset against the base amount."

(3) Exemption for payment under qualified plans.—Subsection (b) of section 280G (defining excess parachute payment) is amended by adding at the end thereof the following new paragraph:

"(6) Exemption for payments under qualified plans.—Notwithstanding paragraph (2), the term 'parachute payment' shall not include any payment to or from—

> *"(A) a plan described in section 401(a) which includes a trust exempt from tax under section 501(a),*
>
> *"(B) an annuity plan described in section 403(a), or*
>
> *"(C) a simplified employee pension (as defined in section 408(k))."*

(4) Treatment of affiliated groups.—Subsection (d) of section 280G is amended by adding at the end thereof the following new paragraph:

"(5) Treatment of affiliated groups.—Except as otherwise provided in regulations, all members of the same affiliated group (as defined in section 1504, determined without regard to section 1504(b)) shall be treated as 1 corporation for purposes of this section. Any person who is an officer or any member of such group shall be treated as an officer of such 1 corporation."

(5) Limitation on number of individuals treated as highly compensated.—Subsection (c) of section 280G (defining disqualified individual) is amended by adding at the end thereof the following new sentence: "For purposes of paragraph (2), the term 'highly-compensated individual' only includes an individual who is (or would be if the individual were an employee) a member of the group consisting of the highest paid 1 percent of the employees of the corporation or, if less, the highest paid 250 employees of the corporation."

(6) EXCLUDED AMOUNTS NOT TAKEN INTO ACCOUNT IN DETERMINING WHETHER THRESHOLD AMOUNT IS MET.—Subparagraph (A) of section 280G(b)(2) (defining parachute payment) is amended by adding at the end thereof the following new sentence:

"For purposes of clause (ii), payments not treated as parachute payments under paragraph (4)(A), (5), or (6) shall not be taken into account."

(7) LIMITATION ON TREATMENT OF PAYMENT PURSUANT TO SECURITIES LAW VIOLATION AS PARACHUTE PAYMENT.—Subparagraph (B) of section 280G(b)(2) (defining parachute payments) is amended to read as follows:

"(B) AGREEMENTS.—The term 'parachute payment' shall also include any payment in the nature of compensation to (or for the benefit of) a disqualified individual if such payment is made pursuant to an agreement which violates any generally enforced securities laws or regulations. In any proceeding involving the issue of whether any payment made to a disqualified individual is a parachute payment on account of a violation of any generally enforced securities laws or regulations, the burden of proof with respect to establishing the occurrence of a violation of such a law or regulation shall be upon the Secretary."

(8) CLERICAL AMENDMENT.—Paragraph (2) of section 280G(d) (defining base period) is amended by striking out "was an employee of the corporation" and inserting in lieu thereof "performed personal services for the corporation".

(k) AMENDMENTS RELATING TO SECTION 68 OF THE ACT.—

(1) NO DISC PREFERENCE REDUCTION FOR S CORPORATIONS.—Effective with respect to taxable years beginning after December 31, 1982, paragraph (4) of section 291(a) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1984) is amended by striking out "a corporation" and inserting in lieu thereof "a C corporation".

(2) CLARIFICATION OF EFFECTIVE DATES.—

(A) Paragraph (2) of section 68(e) of the Tax Reform Act of 1984 (relating to section 1250 gain) is amended by striking out "of the Internal Revenue Code of 1954" and inserting in lieu thereof "of the Internal Revenue Code of 1954, and the amendment made by subsection (c)(2) of this section,".

(B) Paragraph (3) of section 68(e) of the Tax Reform Act of 1984 (relating to pollution control facilities) is amended by striking out "of such Code" and inserting in lieu thereof "of such Code, and so much of the amendment made by subsection (c)(1) of this section as relates to pollution control facilities,".

(3) CLERICAL AMENDMENTS.—

(A) The subsection heading of section 291(a) is amended by striking out "20-PERCENT".

(B) Paragraph (2) of section 68(c) of the Tax Reform Act of 1984 is amended by striking out "section 57(h)" and inserting in lieu thereof "section 57(b)".

(C) Subparagraph (B) of section 57(b)(1) is amended to read as follows:

"(B) IRON ORE AND COAL.—In the case of any item of tax preference of a corporation described in paragraph (8) of subsection (a) (but only to the extent such item is allocable to a deduction for depletion for iron ore and coal, including lignite), only 71.6 percent of the amount of such item of tax preference (determined without regard to this subsection) shall be taken into account as an item of tax preference."

(D) Paragraph (2) of section 57(b) is amended by striking out "85 percent" and inserting in lieu thereof "80 percent".

SEC. 1805. AMENDMENTS RELATED TO PARTNERSHIP PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 72 OF THE ACT.—

(1) CLARIFICATION THAT CHANGE NEED NOT OCCUR DURING TAXABLE YEAR OF PAYMENT.—

(A) Clause (i) of section 706(d)(2)(A) is amended by striking out "each such item" and inserting in lieu thereof "such item".

(B) Subparagraph (B) of section 706(d)(2) is amended by striking out "which are described in paragraph (1) and".

(2) CLERICAL AMENDMENT.—Clause (i) of section 706(d)(2)(C) (relating to items attributable to periods not within taxable year) is amended by striking out "the first day of such taxable year" and inserting in lieu thereof "the first day of the taxable year".

(b) AMENDMENT RELATED TO SECTION 73 OF THE ACT.—Clause (iii) of section 707(a)(2)(B) (relating to treatment of certain property transfers) is amended by striking out "sale of property" and inserting in lieu thereof "sale or exchange of property".

(c) AMENDMENTS RELATED TO SECTION 75 OF THE ACT.—

(1) LIMITATION ON AMOUNT OF GAIN.—Section 386 (relating to transfers of partnership and trust interests by a corporation) is amended by redesignating subsection (d) as subsection (e) and by inserting after subsection (c) the following new subsection:

"(d) LIMITATION ON AMOUNT OF GAIN RECOGNIZED IN CASE OF NON-LIQUIDATING DISTRIBUTIONS.—In the case of any distribution by a corporation to which section 311 applies, the amount of any gain recognized by reason of subsection (a) shall not exceed the amount of the gain which would have been recognized if the partnership interest had been sold. The Secretary may by regulations provide that the amount of such gain shall be computed without regard to any loss attributable to property contributed to the partnership for the principal purpose of recognizing such loss on the distribution."

(2) CLARIFICATION OF SECTION 761(e).—Subsection (e) of section 761 (relating to distributions treated as exchanges) is amended—

(A) by striking out "For purposes of" and inserting in lieu thereof "Except as otherwise provided in regulations, for purposes of",

(B) by striking out "any distribution (not otherwise treated as an exchange)" and inserting in lieu thereof "any distribution of an interest in a partnership (not otherwise treated as an exchange)", and

(C) by striking out "DISTRIBUTIONS" in the subsection heading and inserting in lieu thereof "DISTRIBUTIONS OF PARTNERSHIP INTERESTS".

(d) AMENDMENT RELATED TO SECTION 77 OF THE ACT.—Subparagraph (A) of section 1031(a)(3) (relating to requirement that property be identified) is amended by striking out "before the day" and inserting in lieu thereof "on or before the day".

SEC. 1806. AMENDMENTS RELATED TO TRUST PROVISIONS.

(a) AMENDMENT RELATED TO SECTION 81 OF THE ACT.—Subparagraph (B) of section 643(e)(3), as redesignated by subsection (c) (relating to election to recognize gain), is amended to read as follows:

"(B) ELECTION.—Any election under this paragraph shall apply to all distributions made by the estate or trust during a taxable year and shall be made on the return of such estate or trust for such taxable year."

(b) TREATMENT OF MULTIPLE TRUSTS.—Subsection (b) of section 82 of the Tax Reform Act of 1984 (relating to treatment of multiple trusts) is amended by inserting before the period at the end thereof the following: "; except that, in the case of a trust which was irrevocable on March 1, 1984, such amendment shall so apply only to that portion of the trust which is attributable to contributions to corpus after March 1, 1984".

(c) CLERICAL AMENDMENTS.—Section 643 (relating to definitions applicable to subparts A, B, C, and D) is amended—

(1) by redesignating the subsection added by section 81 of the Tax Reform Act of 1984 as subsection (e), and

(2) by redesignating the subsection added by section 82 of such Act as subsection (f).

SEC. 1807. AMENDMENTS RELATED TO ACCOUNTING CHANGES.

(a) AMENDMENTS RELATED TO SECTION 91 OF THE ACT.—

(1) CLARIFICATION OF CASH BASIS EXCEPTION TO TAX SHELTER RULE.—

(A) Subparagraph (A) of section 461(i)(2) is amended by striking out "within 90 days after the close of the taxable year" and inserting in lieu thereof "before the close of the 90th day after the close of the taxable year".

(B) The heading for paragraph (2) of section 461(i) is amended by striking out "WITHIN 90 DAYS" and inserting in lieu thereof "ON OR BEFORE THE 90TH DAY".

(2) CLARIFICATION OF COORDINATION WITH SECTION 464.—Subparagraph (A) of section 461(i)(4) (relating to special rules for farming) is amended to read as follows:

"(A) any tax shelter described in paragraph (3)(C) shall be treated as a farming syndicate for purposes of section 464; except that this subparagraph shall not apply for purposes of determining the income of an individual meeting the requirements of section 464(c)(2),".

(3) TREATMENT OF MINING AND SOLID WASTE RECLAMATION AND CLOSING COSTS.—

(A) RESERVE INCREASED BY AMOUNT DEDUCTED.—Paragraph (2) of section 468(a) (relating to establishment of reserves for reclamation and closing costs) is amended by adding at the end thereof the following new subparagraph:

"(D) RESERVE INCREASED BY AMOUNT DEDUCTED.—A
serve shall be increased each taxable year by the amou
allowable as a deduction under paragraph (1) for such ta
able year which is allocable to such reserve."

(B) EFFECTIVE DATE.—Subsection (g) of section 91 of t
Tax Reform Act of 1984 (relating to effective dates)
amended by adding at the end thereof the following ne
paragraph:

"(4) EFFECTIVE DATE FOR TREATMENT OF MINING AND SOL
WASTE RECLAMATION AND CLOSING COSTS.—Except as otherwi
provided in subsection (h), the amendments made by subsectio
(b) shall take effect on the date of the enactment of this A
with respect to taxable years ending after such date."

(C) CLERICAL AMENDMENT.—Paragraph (1) of sectio
468(a) is amended by striking out "this subsection" and i
serting in lieu thereof "this section".

(4) TREATMENT OF DECOMMISSIONING OF NUCLEAR POWE
PLANT.—

(A) TIME WHEN PAYMENTS DEEMED MADE.—

(i) IN GENERAL.—Section 468A is amended by addin
at the end thereof the following new subsection:

"(g) TIME WHEN PAYMENTS DEEMED MADE.—For purposes of thi
section, a taxpayer shall be deemed to have made a payment to th
Fund on the last day of a taxable year if such payment is made o
account of such taxable year and is made within 2½ months afte
the close of such taxable year."

(ii) TRANSITIONAL RULE.—To the extent provided i
regulations prescribed by the Secretary of the Treasur
or his delegate, subsection (g) of section 468A of the In
ternal Revenue Code of 1954 (as added by clause (i
shall be applied with respect to any payment on ac
count of a taxable year beginning before January 1
1987, as if it did not contain the requirement that th
payment be made within 2½ months after the close o
the taxable year. Such regulations may provide that, t
the extent such payment to the Fund is made mor
than 2½ months after the close of the taxable year, an
adjustment to the tax attributable to such paymen
shall not affect the amount of interest payable with respect to periods before the payment is made. Such regulations may provide appropriate adjustments to the deduction allowed under such section 468A for any such taxable year to take into account the fact that the payment to the Fund is made more than 2½ months after the close of the taxable year.

(B) TREATMENT OF AMOUNTS DISTRIBUTED.—Subparagraph (A) of section 468A(c)(1) (relating to inclusion of amount distributed) is amended by striking out "subsection (e)(2)(B)" and inserting in lieu thereof "subsection (e)(4)(B)".

(C) CLARIFICATION OF TAXATION OF FUND.—Paragraph (2) of section 468A(e) (relating to taxation of Fund) is amended to read as follows:

"(2) TAXATION OF FUND.—

"(A) In general.—There is hereby imposed on the gross income of the Fund for any taxable year a tax at a rate equal to the highest rate of tax specified in section 11(b), except that—

"(i) there shall not be included in the gross income of the Fund any payment to the Fund with respect to which a deduction is allowable under subsection (a), and

"(ii) there shall be allowed as a deduction to the Fund any amount paid by the Fund which is described in paragraph (4)(B) (other than an amount paid to the taxpayer) and which would be deductible under this chapter for purposes of determining the taxable income of a corporation.

"(B) Tax in lieu of other taxation.—The tax imposed by subparagraph (A) shall be in lieu of any other taxation under this subtitle of the income from assets in the Fund.

"(C) Fund treated as corporation.—For purposes of subtitle F—

"(i) the Fund shall be treated as if it were a corporation, and

"(ii) any tax imposed by this paragraph shall be treated as a tax imposed by section 11."

(D) Limitation on investments.—Paragraph (4) of section 468A(e) is amended by striking out "and" at the end of subparagraph (A), by striking out the period at the end of subparagraph (B) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(C) to the extent that a portion of the Fund is not currently needed for purposes described in subparagraph (A) or (B), making investments described in section 501(c)(21)(B)(ii)."

(E) Clerical amendments.—

(i) Subsection (a) of section 468A is amended by striking out "this subsection" and inserting in lieu thereof "this section".

(ii) Subsection (d) of section 468A is amended by striking out "this subsection" in the material preceding paragraph (1) and inserting in lieu thereof "this section".

(iii) The subsection heading for subsection (e) of section 468A is amended by striking out "Trust Fund" and inserting in lieu thereof "Reserve Fund".

(iv) Paragraph (1) of section 468A(e) is amended—

(I) by striking out "this subsection" and inserting in lieu thereof "this section", and

(II) by striking out "Trust Fund" and inserting in lieu thereof "Reserve Fund".

(v) Paragraph (6) of section 468A(e) is amended—

(I) by striking out "this subsection" each place it appears and inserting in lieu thereof "this section", and

(II) by striking out "this subparagraph" and inserting in lieu thereof "this paragraph".

(vi) Subsection (f) of section 468A is amended by striking out "The term" and inserting in lieu thereof "For purposes of this section, the term".

(vii) Section 88 is amended by striking out "of ratemaking purposes" and inserting in lieu thereof "for ratemaking purposes".

(F) EFFECTIVE DATE.—Subsection (g) of section 91 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraph:

"(5) RULES FOR NUCLEAR DECOMMISSIONING COSTS.—The amendments made by subsections (c) and (f) shall take effect on the date of the enactment of this Act with respect to taxable years ending after such date."

(5) EFFECTIVE DATE FOR NET OPERATING LOSS PROVISIONS.—Subsection (g) of section 91 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraph:

"(6) MODIFICATION OF NET OPERATING LOSS CARRYBACK PERIOD.—The amendments made by subsection (d) shall apply to losses for taxable years beginning after December 31, 1983."

(6) CLARIFICATION OF ELECTION FOR EARLIER EFFECTIVE DATE.—Subparagraph (A) of section 91(g)(2) of the Tax Reform Act of 1984 (relating to taxpayer may elect earlier application) is amended—

(A) by striking out "incurred before" and inserting in lieu thereof "incurred on or before",

(B) by striking out "incurred on or after" and inserting in lieu thereof "incurred after", and

(C) by adding at the end thereof the following new sentence:

"The Secretary of the Treasury or his delegate may by regulations provide that (in lieu of an election under the preceding sentence) a taxpayer may (subject to such conditions as such regulations may provide) elect to have subsection (h) of section 461 of such Code apply to the taxpayer's entire taxable year in which occurs July 19, 1984."

(7) SPECIAL RULES FOR DESIGNATED SETTLEMENT FUNDS.—

(A) IN GENERAL.—Subpart C of part II of subchapter E of chapter 1 (relating to taxable year for which deduction taken) is amended by adding at the end thereof the following new section:

"SEC. 468B. SPECIAL RULES FOR DESIGNATED SETTLEMENT FUNDS.

"(a) IN GENERAL.—For purposes of section 461(h), economic performance shall be deemed to occur as qualified payments are made by the taxpayer to a designated settlement fund.

"(b) TAXATION OF DESIGNATED SETTLEMENT FUND.—

"(1) IN GENERAL.—There is imposed on the gross income of any designated settlement fund for any taxable year a tax at a rate equal to the maximum rate in effect for such taxable year under section 1(e).

"(2) Certain expenses allowed.—For purposes of paragraph (1), gross income for any taxable year shall be reduced by the amount of any administrative costs (including State and local taxes) and other incidental expenses of the designated settlement fund (including legal, accounting, and actuarial expenses)—

"(A) which are incurred in connection with the operation of the fund, and

"(B) which would be deductible under this chapter for purposes of determining the taxable income of the corporation,

no other deduction shall be allowed to the fund.

"(3) Transfers to the fund.—In the case of any qualified payment made to the fund—

"(A) the amount of such payment shall not be treated as income of the designated settlement fund,

"(B) the basis of the fund in any property which constitutes a qualified payment shall be equal to the fair market value of such property at the time of payment, and

"(C) the fund shall be treated as the owner of the property in the fund (and any earnings thereon).

"(4) Tax in lieu of other taxation.—The tax imposed by paragraph (1) shall be in lieu of any other taxation under this subtitle of income from assets in the designated settlement fund.

"(5) Coordination with subtitle F.—For purposes of subtitle F—

"(A) a designated settlement fund shall be treated as a corporation, and

"(B) any tax imposed by this subsection shall be treated as a tax imposed by section 11.

"(c) Deductions not Allowed for Transfer of Insurance Amounts.—No deduction shall be allowable for any qualified payment by the taxpayer of any amounts received from the settlement of any insurance claim to the extent such amounts are excluded from the gross income of the taxpayer.

"(d) Definitions.—For purposes of this section—

"(1) Qualified payment.—The term 'qualified payment' means any money or property which is transferred to any designated settlement fund pursuant to a court order, other than—

"(A) any amount which may be transferred from the fund to the taxpayer, or

"(B) the transfer of any stock or indebtedness of the taxpayer (or any related person).

"(2) Designated settlement fund.—The term 'designated settlement fund' means any fund—

"(A) which is established pursuant to a court order,

"(B) with respect to which no amounts may be transferred other than in the form of qualified payments,

"(C) which is administered by persons a majority of whom are independent of the taxpayer,

"(D) which is established for the principal purpose of resolving and satisfying present and future claims against the taxpayer (or any related person or formerly related

person) arising out of personal injury, death, or property damage,

"(E) under the terms of which the taxpayer may not hold any beneficial interest in the income or corpus of the fund, and

"(F) with respect to which an election is made under this section by the taxpayer.

An election under this section shall be made at such time and in such manner as the Secretary shall by regulation prescribe. Such an election, once made, may be revoked only with the consent of the Secretary.

"(3) RELATED PERSON.—The term 'related person' means a person related to the taxpayer within the meaning of section 267(b).

"(e) NONAPPLICABILITY OF SECTION.—This section shall not apply with respect to any liability of the taxpayer arising under any workers' compensation Act or any contested liability of the taxpayer within the meaning of section 461(f).

"(f) OTHER FUNDS.—Except as provided in regulations, any payment in respect of a liability described in subsection (d)(2)(D) (and not described in subsection (e)) to a trust fund or escrow fund which is not a designated settlement fund shall not be treated as constituting economic performance."

(B) CLERICAL AMENDMENT.—The table of sections for subpart C of part II of subchapter E of chapter 1 is amended by adding after the item relating to section 468A the following new item:

"Sec. 468B. Special rules for designated settlement funds."

(C) SPECIAL RULE FOR TAXPAYER IN BANKRUPTCY REORGANIZATION.—In the case of any settlement fund which is established for claimants against a corporation which filed a petition for reorganization under chapter 11 of title 11, United States Code, on August 26, 1982, and which filed with a United States district court a first amended and restated plan of reorganization before March 1, 1986—

(i) any portion of such fund which meets the requirements of subparagraphs (A), (C), (D), and (F) of section 468B(d)(2) of the Internal Revenue Code of 1954 (as added by this paragraph) shall be treated as a designated settlement fund for purposes of section 468B of such Code,

(ii) such corporation (or any successor thereof) shall be liable for the tax imposed by section 468B of such Code on such portion of the fund (and the fund shall not be liable for such tax), such tax shall be deductible by the corporation, and the rate of tax under section 468B of such Code for any taxable year shall be equal to 15 percent, and

(iii) any transaction by any portion of the fund not described in clause (i) shall be treated as a transaction made by the corporation.

(D) CLARIFICATION OF LAW WITH RESPECT TO CERTAIN FUNDS.—

(i) In general.—Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. If contributions to such an account or fund are not deductible, then the account or fund shall be taxed as a grantor trust.

(ii) Effective date.—The provisions of clause (i) shall apply to accounts or funds established after August 16, 1986.

(8) Transitional rule for certain amounts.—For purposes of section 461(h) of the Internal Revenue Code of 1954, economic performance shall be treated as occurring on the date of a payment to an insurance company if—

(A) such payment was made before November 23, 1985, for indemnification against a tort liability relating to personal injury or death caused by inhalation or ingestion of dust from asbestos-containing insulation products,

(B) such insurance company is unrelated to taxpayer,

(C) such payment is not refundable, and

(D) the taxpayer is not engaged in the mining of asbestos nor is any member of any affiliated group which includes the taxpayer so engaged.

(b) Amendments Related to Section 92 of the Act.—

(1) Treatment of services.—Subsection (g) of section 467 (relating to comparable rules for services) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to any amount to which section 404 or 404A (or any other provision specified in regulations) applies."

(2) Clerical amendments.—

(A) Subparagraph (A) of section 467(b)(4) is amended by striking out "statutory recover period" and inserting in lieu thereof "statutory recovery period".

(B) Paragraph (4) of section 467(c) is amended by striking out "subsection (b)(3)(A)" and inserting in lieu thereof "subsection (b)(4)(A)".

(C) The last sentence of section 467(d)(2) is amended by striking out "section 1274(c)(2)(C)" and inserting in lieu thereof "section 1274(c)(4)(C)".

(D) Paragraph (5) of section 467(e) is amended by striking out "section 168(d)(4)(D)" and inserting in lieu thereof "section 168(e)(4)(D)".

(c) Transition Rule.—A taxpayer shall be allowed to use the cash receipts and disbursements method of accounting for taxable years ending after January 1, 1982, if such taxpayer—

(1) is a partnership which was founded in 1936,

(2) has over 1,000 professional employees,

(3) used a long-term contract method of accounting for a substantial part of its income from the performance of architectural and engineering services, and

(4) is headquartered in Chicago, Illinois.

SEC. 1808. AMENDMENTS RELATED TO TAX STRADDLE PROVISIONS.

(a) Treatment of Subchapter S Corporations.—

(1) Section 102 of the Tax Reform Act of 1984 (relating to section 1256 extended to certain options) is amended by adding at the end thereof the following new subsection:

"(j) Coordination of Election Under Subsection (d)(3) With Elections Under Subsections (g) and (h).—The Secretary of the Treasury or his delegate shall prescribe such regulations as may be necessary to coordinate the election provided by subsection (d)(3) with the elections provided by subsections (g) and (h)."

(2) Paragraph (3) of section 102(d) of the Tax Reform Act of 1984 (relating to subchapter S election) is amended by striking out "(as so defined)" and inserting in lieu thereof "(as so defined) or such other day as may be permitted under regulations".

(b) Treatment of Amounts Received for Loaning Securities.—Subparagraph (B) of section 263(g)(2) (defining interest and carrying charges) is amended by striking out "and" at the end of clause (ii), by striking out the period at the end of clause (iii) and inserting in lieu thereof ", and", and by inserting after clause (iii) the following new clause:

"(iv) any amount which is a payment with respect to a security loan (within the meaning of section 512(a)(5)) includible in gross income with respect to such property for the taxable year."

(c) Treatment of Option Straddles.—Subparagraph (A) of section 1092(d)(3) (relating to special rules for stocks) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to any interest in stock."

(d) Section 108.—Section 108 of the Tax Reform Act of 1984 is amended—

(1) by striking out "if such position is part of a transaction entered into for profit" and inserting in lieu thereof "if such loss is incurred in a trade or business, or if such loss is incurred in a transaction entered into for profit though not connected with a trade or business",

(2) by striking out subsection (b) and inserting in lieu thereof the following:

"(b) Loss Incurred in a Trade or Business.—For purposes of subsection (a), any loss incurred by a commodities dealer in the trading of commodities shall be treated as a loss incurred in a trade or business.",

(3) by striking out the heading for subsection (c) and inserting in lieu thereof the following:

"(c) Net Loss Allowed.—",

(4) by striking out subsection (f) and inserting in lieu thereof the following:

"(f) Commodities Dealer.—For purposes of this section, the term 'commodities dealer' means any taxpayer who—

"(1) at any time before January 1, 1982, was an individual described in section 1402(i)(2)(B) of the Internal Revenue Code of 1954 (as added by this subtitle), or

"(2) was a member of the family (within the meaning of section 704(e)(3) of such Code) of an individual described in paragraph (1) to the extent such member engaged in commodities trading through an organization the members of which consisted solely of—

"(A) 1 or more individuals described in paragraph (1), and

"(B) 1 or more members of the families (as so defined) of such individuals.", and

(4) by striking out subsection (h) and inserting in lieu thereof the following:

"(h) SYNDICATES.—For purposes of this section, any loss incurred by a person (other than a commodities dealer) with respect to an interest in a syndicate (within the meaning of section 1256(e)(3)(B) of the Internal Revenue Code of 1954) shall not be considered to be a loss incurred in a trade or business."

SEC. 1809. AMENDMENTS RELATED TO DEPRECIATION PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 111 OF THE ACT.—

(1) 15-YEAR STRAIGHT LINE ELECTION FOR LOW-INCOME HOUSING.—The table contained in subparagraph (A) of section 168(b)(3) (relating to election of different recovery percentage) is amended—

(A) by striking out "and low-income housing" in the last item, and

(B) by adding at the end thereof the following new item:

"Low-income housing .... 15, 35, or 45 years."

(2) USE OF CONVENTIONS.—

(A) MID-MONTH CONVENTION FOR 19-YEAR REAL PROPERTY.—

(i) Paragraph (2) of section 168(b) (relating to 19-year real property) is amended—

(I) by striking out the last sentence of subparagraph (A), and

(II) by amending subparagraph (B) to read as follows:

"(B) MID-MONTH CONVENTION FOR 19-YEAR REAL PROPERTY.—In the case of 19-year real property, the amount of the deduction determined under any provision of this section (or for purposes of section 57(a)(12)(B) or 312(k)) for any taxable year shall be determined on the basis of the number of months (using a mid-month convention) in which the property is in service."

(ii) Subparagraph (B) of section 168(f)(2) (relating to recovery property used predominantly outside the United States) is amended to read as follows:

"(B) REAL PROPERTY.—Except as provided in subparagraph (C), in the case of 19-year real property or low-income housing which, during the taxable year, is predominantly used outside the United States, the recovery deduction for the taxable year shall be, in lieu of the amount determined under subsection (b), the amount determined by applying to the unadjusted basis of such property the applicable percentage determined under tables prescribed by the Secretary. For purposes of the preceding sentence, in prescribing such tables, the Secretary shall—

"(i) assign to the property described in this subparagraph a 35-year recovery period, and

"(ii) assign percentages determined in accordance with the use of the method of depreciation described in section 167(j)(1)(B), switching to the method described in section 167(b)(1) at a time to maximize the deduction allowable under subsection (a)."

(B) MONTHLY CONVENTION FOR LOW-INCOME HOUSING.—Subparagraph (B) of section 168(b)(4) (relating to low-income housing) is amended to read as follows:

"(B) MONTHLY CONVENTION.—In the case of low-income housing, the amount of the deduction determined under any provision of this section (or for purposes of section 57(a)(12)(B) or 312(k)) for any taxable year shall be determined on the basis of the number of months (treating all property placed in service or disposed of during any month as placed in service or disposed of on the first day of such month) in which the property is in service."

(C) CONFORMING AMENDMENTS.—

(i) Effective on and after the date of the enactment of this Act, clause (ii) of section 168(j)(2)(B) (relating to conventions) is amended to read as follows:

"(ii) CROSS REFERENCE.—

"For other applicable conventions, see paragraphs (2)(B) and (4)(B) of subsection (b)."

(ii) Subparagraph (A) of section 312(k)(3) is amended by striking out ", and rules similar to the rules under the next to the last sentence of section 168(b)(2)(A) and section 168(b)(2)(B) shall apply".

(3) MINIMUM TAX TREATMENT.—Subparagraph (B) of section 57(a)(12) (relating to 19-year real property and low-income housing) is amended by striking out so much of such subparagraph as precedes clause (i) thereof and inserting in lieu thereof the following:

"(B) 19-YEAR REAL PROPERTY AND LOW-INCOME HOUSING.—With respect to each recovery property which is 19-year real property or low-income housing, the amount (if any) by which the deduction allowed under section 168(a) (or, in the case of property described in section 167(k), under section 167) for the taxable year exceeds the deduction which would have been allowable for the taxable year had the property been depreciated using a straight-line method (without regard to salvage value) over a recovery period of—".

(4) TREATMENT OF PROPERTY FINANCED WITH TAX-EXEMPT BONDS.—

(A) Clause (ii) of section 168(f)(12)(B) (relating to recovery method) is amended to read as follows:

"(ii) 19-YEAR REAL PROPERTY.—In the case of 19-year real property, the amount of the deduction allowed shall be determined by using the straight-line method (without regard to salvage value) and a recovery period of 19 years."

(B) Subparagraph (C) of section 168(f)(12) (relating to exception for projects for residential rental property) is amended to read as follows:

"(C) Exception for low- and moderate-income housing.—Subparagraph (A) shall not apply to—

"(i) any low-income housing, and

"(ii) any other recovery property which is placed in service in connection with projects for residential rental property financed by the proceeds of obligations described in section 103(b)(4)(A)."

(C) Any property described in paragraph (3) of section 631(d) of the Tax Reform Act of 1984 shall be treated as property described in clause (ii) of section 168(f)(12)(C) of the Internal Revenue Code of 1954 as amended by subparagraph (B).

(5) Coordination with imputed interest changes.—In the case of any property placed in service before May 9, 1985 (or treated as placed in service before such date by section 105(b)(3) of Public Law 99–121)—

(A) any reference in any amendment made by this subsection to 19-year real property shall be treated as a reference to 18-year real property, and

(B) section 168(f)(12)(B)(ii) of the Internal Revenue Code of 1954 (as amended by paragraph (4)(A)) shall be applied by substituting "18 years" for "19 years".

(b) Treatment of Transferee in Certain Transactions.—

(1) In general.—Subparagraph (A) of section 168(f)(10) (relating to transferee bound by transferor's period and method in certain cases) is amended to read as follows:

"(A) In general.—In the case of recovery property transferred in a transaction described in subparagraph (B), for purposes of computing the deduction allowable under subsection (a) with respect to so much of the basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor—

"(i) if the transaction is described in subparagraph (B)(i), the transferee shall be treated in the same manner as the transferor, or

"(ii) if the transaction is described in clause (ii) or (iii) of subparagraph (B) and the transferor made an election with respect to such property under subsection (b)(3) or (f)(2)(C), the transferee shall be treated as having made the same election (or its equivalent)."

(2) Treatment of terminations of partnerships.—Subparagraph (B) of section 168(f)(10) is amended by adding at the end thereof the following new sentence:

"Clause (i) shall not apply in the case of the termination of a partnership under section 708(b)(1)(B)."

(3) Effective date.—The amendments made by this subsection shall apply to property placed in service by the transferee after December 31, 1985, in taxable years ending after such date.

(c) Amendment Related to Section 112 of the Act.—Paragraph (2) of section 453(i) (defining recapture income) is amended by

striking out "section 1245 or 1250" and inserting in lieu thereof "section 1245 or 1250 (or so much of section 751 as relates to section 1245 or 1250)".

(d) AMENDMENTS RELATED TO SECTION 113 OF THE ACT.—

(1) TREATMENT OF FILMS, VIDEO TAPES, AND SOUND RECORDINGS.—Except with respect to property placed in service by the taxpayer on or before March 28, 1985, subsection (c) of section 167 (relating to limitations on use of certain methods and rates) is amended by adding at the end thereof the following new sentence:

"Paragraphs (2), (3), and (4) of subsection (b) shall not apply to any motion picture film, video tape, or sound recording."

(2) CLERICAL AMENDMENT.—Subsection (q) of section 48 is amended by redesignating the paragraph relating to special rule for qualified films as paragraph (7).

(e) AMENDMENTS RELATED TO SECTION 114 OF THE ACT.—

(1) Paragraph (1) of section 48(b) (defining new section 38 property) is amended by adding at the end thereof the following new sentence: "Such term includes any section 38 property the reconstruction of which is completed by the taxpayer, but only with respect to that portion of the basis which is properly attributable to such reconstruction."

(2) Paragraph (2) of section 48(b) (relating to special rule for sale-leasebacks) is amended—

(A) by striking out "paragraph (1)" and inserting in lieu thereof "the first sentence of paragraph (1)",

(B) by striking out "used under the lease" and inserting in lieu thereof "used under the leaseback (or lease) referred to in subparagraph (B)",

(C) by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to any property if the lessee and lessor of such property make an election under this sentence. Such an election, once made, may be revoked only with the consent of the Secretary.", and

(D) by striking out "3 months of" in subparagraph (B) and inserting in lieu thereof "3 months after".

SEC. 1810. AMENDMENTS RELATED TO FOREIGN PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 121 OF THE ACT.—

(1) TREATMENT OF CERTAIN DOMESTIC CORPORATIONS.—

(A) IN GENERAL.—Subsection (g) of section 904 (relating to source rules in the case of United States-owned foreign corporations) is amended by redesignating paragraph (9) as paragraph (10), and by inserting after paragraph (8) the following new paragraph:

"(9) TREATMENT OF CERTAIN DOMESTIC CORPORATIONS.—For purposes of this subsection—

"(A) in the case of interest treated as not from sources within the United States under section 861(a)(1)(B), the corporation paying such interest shall be treated as a United States-owned foreign corporation, and

"(B) in the case of any dividend treated as not from sources within the United States under section 861(a)(2)(A),

the corporation paying such dividend shall be treated as a United States-owned foreign corporation."

(B) Effective date.—The amendment made by subparagraph (A) shall take effect on March 28, 1985. In the case of any taxable year ending after such date of any corporation treated as a United States-owned foreign corporation by reason of the amendment made by subparagraph (A)—

(i) only income received or accrued by such corporation after such date shall be taken into account under section 904(g) of the Internal Revenue Code of 1954; except that

(ii) paragraph (5) of such section 904(g) shall be applied by taking into account all income received or accrued by such corporation during such taxable year.

(2) Treatment of certain foreign corporations engaged in trade or businesses within the United States.—Subparagraph (E) of section 121(b)(2) of the Tax Reform Act of 1984 (relating to special rules for applicable CFC) is amended by adding at the end thereof the following new clause:

"(iii) Treatment of certain foreign corporations engaged in business in United States.—For purposes of clause (ii), a foreign corporation shall be treated as a United States person with respect to any interest payment made by such corporation if—

"(I) at least 50 percent of the gross income from all sources of such corporation for the 3-year period ending with the close of its last taxable year ending on or before March 31, 1984, was effectively connected with the conduct of a trade or business within the United States, and

"(II) at least 50 percent of the gross income from all sources of such corporation for the 3-year period ending with the close of its taxable year preceding the payment of such interest was effectively connected with the conduct of a trade or business within the United States."

(3) Treatment of certain short-term borrowing.—Clause (ii) of section 121(b)(2)(D) of the Tax Reform Act of 1984 (defining applicable CFC) is amended by striking out "or the holding of short-term obligations" and all that follows and inserting in lieu thereof "(or short-term borrowing from nonaffiliated persons) and lending the proceeds of such obligations (or such borrowing) to affiliates."

(4) Coordination with treaty obligations.—Section 904(g) of the Internal Revenue Code of 1954 shall apply notwithstanding any treaty obligation of the United States to the contrary (whether entered into on, before, or after the date of the enactment of this Act) unless (in the case of a treaty entered into after the date of the enactment of this Act) such treaty by specific reference to such section 904(g) clearly expresses the intent to override the provisions of such section.

(5) Transitional rule related to section 125(b)(5) of the Act.—For purposes of section 125(b)(5) of the Tax Reform Act of 1984 (relating to separate application of section 904 in case of

income covered by transitional rules), any carryover under section 904(c) of the Internal Revenue Code of 1954 allowed to a taxpayer which was incorporated on August 31, 1962, attributable to taxes paid or accrued in taxable years beginning in 1981, 1982, 1983, or 1984, with respect to amounts included in gross income under section 951 of such Code in respect of a controlled foreign corporation which was incorporated on May 27, 1977, shall be treated as taxes paid or accrued on income separately treated under such section 125(b)(5).

(b) AMENDMENTS RELATED TO SECTION 122 OF THE ACT.—

(1) TREATMENT OF SUBPART F AND FOREIGN PERSONAL HOLDING COMPANY INCLUSIONS.—Subparagraph (C) of section 904(d)(3) (relating to exception where designated corporation has small amount of separate limitation interest) is amended by adding at the end thereof the following new sentence:

> *"The preceding sentence shall not apply to any amount includible in gross income under section 551 or 951."*

(2) TREATMENT OF INTEREST AND DIVIDENDS FROM MEMBERS OF SAME AFFILIATED GROUP.—Paragraph (3) of section 904(d) (relating to certain amounts attributable to United States-owned foreign corporations, etc., treated as interest) is amended by striking out subparagraph (J), by redesignating subparagraph (I) as subparagraph (J), and by inserting after subparagraph (H) the following new subparagraph:

> *"(I) INTEREST AND DIVIDENDS FROM MEMBERS OF SAME AFFILIATED GROUP.—For purposes of this paragraph, dividends and interest received or accrued by the designated payor corporation from another member of the same affiliated group (determined under section 1504 without regard to subsection (b)(3) thereof) shall be treated as separate limitation interest if (and only if) such amounts are attributable (directly or indirectly) to separate limitation interest of any other member of such group."*

(3) TREATMENT OF INTEREST FROM DESIGNATED PAYOR CORPORATION.—Paragraph (2) of section 904(d) is amended by inserting at the end thereof the following: "For purposes of this subsection, interest (after the operation of section 904(d)(3)) received from a designated payor corporation described in section 904(d)(3)(E)(iii) by a taxpayer which owns directly or indirectly less than 10 percent of the voting stock of such designated payor corporation shall be treated as interest described in subparagraph (A) to the extent such interest would have been so treated had such taxpayer received it from other than a designated payor corporation."

(4) DEFINITION OF DESIGNATED PAYOR CORPORATION.—

(A) IN GENERAL.—Subparagraph (E) of section 904(d)(3) (defining designated payor corporation) is amended by striking out "and" at the end of clause (ii), by striking out the period at the end of clause (iii) and inserting in lieu thereof ", and", and by adding at the end thereof the following:

> *"(iv) any other corporation formed or availed of for purposes of avoiding the provisions of this paragraph.*

For purposes of this paragraph, the rules of paragraph (9) of subsection (g) shall apply."

(B) EFFECTIVE DATES.—

(i) The amendment made by subparagraph (A) insofar as it adds the last sentence to subparagraph (E) of section 905(d)(3) shall take effect on March 28, 1985. In the case of any taxable year ending after such date of any corporation treated as a designated payor corporation by reason of the amendment made by subparagraph (A)—

(I) only income received or accrued by such corporation after such date shall be taken into account under section 904(d)(3) of the Internal Revenue Code of 1954; except that

(II) subparagraph (C) of such section 904(d)(3) shall be applied by taking into account all income received or accrued by such corporation during such taxable year.

(ii) The amendment made by subparagraph (A) insofar as it adds clause (iv) to subparagraph (E) of section 904(d)(3) shall take effect on December 31, 1985. For purposes of such amendment, the rule of the second sentence of clause (i) shall be applied by taking into account December 31, 1985, in lieu of March 28, 1985.

(c) AMENDMENTS RELATED TO SECTION 123 OF THE ACT.—

(1) Subparagraph (A) of section 956(b)(3) (relating to certain trade or service receivables acquired from related United States persons) is amended by striking out "paragraph (2)" and inserting in lieu thereof "paragraph (2) (other than subparagraph (H) thereof)".

(2) Subsection (d) of section 864 (relating to treatment of related person factoring income) is amended by redesignating paragraph (7) as paragraph (8) and by inserting after paragraph (6) the following new paragraph:

"(7) EXCEPTION FOR CERTAIN RELATED PERSONS DOING BUSINESS IN SAME FOREIGN COUNTRY.—Paragraph (1) shall not apply to any trade or service receivable acquired by any person from a related person if—

"(A) the person acquiring such receivable and such related person are created or organized under the laws of the same foreign country and such related person has a substantial part of its assets used in its trade or business located in such same foreign country, and

"(B) such related person would not have derived any foreign base company income (as defined in section 954(a), determined without regard to section 954(b)(3)(A)), or any income effectively connected with the conduct of a trade or business within the United States, from such receivable if it had been collected by such related person."

(3) Clause (i) of section 864(d)(5)(A) (relating to certain provisions not to apply) is amended by inserting before the period at the end thereof the following: "and subparagraph (J) of section 904(d)(3) (relating to interest from members of same affiliated group)".

(d) AMENDMENTS RELATED TO SECTION 127 OF THE ACT.—

(1) DEFINITION OF PORTFOLIO INTEREST.—

(A) Paragraph (2) of section 871(h) (defining portfolio interest) is amended by striking out "which is described in" in the matter preceding subparagraph (A) and inserting in lieu thereof "which would be subject to tax under subsection (a) but for this subsection and which is described in".

(B) Paragraph (2) of section 881(c) (defining portfolio interest) is amended by striking out "which is described in" in the matter preceding subparagraph (A) and inserting in lieu thereof "which would be subject to tax under subsection (a) but for this subsection and which is described in".

(2) ATTRIBUTION OF SHAREHOLDER STOCK TO CORPORATION.—Subparagraph (C) of section 871(h)(3) (relating to portfolio interest not to include interest received by 10-percent shareholders) is amended by striking out "and" at the end of clause (i), by redesignating clause (ii) as clause (iii), and by inserting after clause (i) the following new clause:

"(ii) section 318(a)(3)(C) shall be applied—

"(I) without regard to the 50-percent limitation therein; and

"(II) in any case where such section would not apply but for subclause (I), by considering a corporation as owning the stock (other than stock in such corporation) which is owned by or for any shareholder of such corporation in that proportion which the value of the stock which such shareholder owns in such corporation bears to the value of all stock in such corporation, and".

(3) CLERICAL AMENDMENTS.—

(A) Paragraph (1) of section 871(a) is amended by striking out "provided in subsection (i)" in the matter preceding subparagraph (A), and inserting in lieu thereof "provided in subsection (h)".

(B) Clause (ii) of section 871(h)(2)(B) is amended by striking out "has received" and inserting in lieu thereof "receives".

(C) Clause (ii) of section 881(c)(2)(B) is amended by striking out "has received" and inserting in lieu thereof "receives".

(D) Paragraph (9) of section 1441(c) is amended by striking out "871(h)(2)" and inserting in lieu thereof "section 871(h)".

(E) Subsection (a) of section 1442 is amended—

(i) by striking out "sections 871(h)(2)" and inserting in lieu thereof "sections 871(h)",

(ii) by striking out "sections 881(c)(2)" and inserting in lieu thereof "sections 881(c)", and

(iii) by striking out "section 1449(c)(9)" and inserting in lieu thereof "section 1441(c)(9)".

(e) AMENDMENTS RELATED TO SECTION 128 OF THE ACT.—

(1) DEDUCTION FOR ORIGINAL ISSUE DISCOUNT.—

(A) Subparagraph (A) of section 163(e)(3) (relating to special rule for original issue discount on obligation held by

related foreign person) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to the extent that the original issue discount is effectively connected with the conduct by such foreign related person of a trade or business within the United States unless such original issue discount is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States."

(B) Subsection (e) of section 163 is amended by redesignating the paragraph relating to cross references as paragraph (5).

(2) TAXATION OF ORIGINAL ISSUE DISCOUNT.—

(A) Subparagraph (C) of section 871(a)(1) (relating to income not connected with United States business) is amended to read as follows:

"(C) in the case of—

"(i) a sale or exchange of an original issue discount obligation, the amount of the original issue discount accruing while such obligation was held by the nonresident alien individual (to the extent such discount was not theretofore taken into account under clause (ii)), and

"(ii) a payment on an original issue discount obligation, an amount equal to the original issue discount accruing while such obligation was held by the nonresident alien individual (except that such original issue discount shall be taken into account under this clause only to the extent such discount was not theretofore taken into account under this clause and only to the extent that the tax thereon does not exceed the payment less the tax imposed by subparagraph (A) thereon), and".

(B) Paragraph (3) of section 881(a) (relating to tax on income of foreign corporations not connected with United States business) is amended to read as follows:

"(3) in the case of—

"(A) a sale or exchange of an original issue discount obligation, the amount of the original issue discount accruing while such obligation was held by the foreign corporation (to the extent such discount was not theretofore taken into account under subparagraph (B)), and

"(B) a payment on an original issue discount obligation, an amount equal to the original issue discount accruing while such obligation was held by the foreign corporation (except that such original issue discount shall be taken into account under this subparagraph only to the extent such discount was not theretofore taken into account under this subparagraph and only to the extent that the tax thereon does not exceed the payment less the tax imposed by paragraph (1) thereon), and".

(f) AMENDMENTS RELATED TO SECTION 129 OF THE ACT.—

(1) TREATMENT OF ELECTIONS UNDER SECTION 897(i).—

(A) Paragraph (1) of section 897(i) (relating to election by foreign corporation to be treated as domestic corporation) is

amended by striking out "and section 6039C" and inserting in lieu thereof ", section 1445, and section 6039C".

(B) Paragraph (4) of section 897(i) is amended by striking out "this section and section 6039C" and inserting in lieu thereof "this section, section 1445, and section 6039C".

(2) Exemption for interests in certain corporations.—Paragraph (3) of section 1445(b) (relating to nonpublicly traded domestic corporation furnishing affidavit that it is not a United States real property holding corporation) is amended to read as follows:

"(3) Nonpublicly traded domestic corporation furnishes affidavit that interests in corporation not United States real property interests.—Except as provided in paragraph (7), this paragraph applies in the case of a disposition of any interest in any domestic corporation if the domestic corporation furnishes to the transferee an affidavit by the domestic corporation stating, under penalty of perjury, that—

"(A) the domestic corporation is not and has not been a United States real property holding corporation (as defined in section 897(c)(2)) during the applicable period specified in section 897(c)(1)(A)(ii), or

"(B) as of the date of the disposition, interests in such corporation are not United States real property interests by reason of section 897(c)(1)(B)."

(3) Notice of false affidavit.—

(A) Clause (i) of section 1445(d)(1)(B) (relating to notice of false affidavit; foreign corporations) is amended to read as follows:

"(i) any transferor's agent—

"(I) such agent has actual knowledge that such affidavit is false, or

"(II) in the case of an affidavit described in subsection (b)(2) furnished by a corporation, such corporation is a foreign corporation, or".

(B) Paragraph (1) of section 1445(d) is amended by striking out "described in paragraph (2)(A)" and inserting in lieu thereof "described in paragraph (2)".

(4) Treatment of certain domestic partnerships, trusts, and estates.—

(A) In general.—Paragraph (1) of section 1445(e) (relating to certain domestic partnerships, trusts, and estates) is amended to read as follows:

"(1) Certain domestic partnerships, trusts, and estates.—In the case of any disposition of a United States real property interest as defined in section 897(c) (other than a disposition described in paragraph (4) or (5)) by a domestic partnership, domestic trust, or domestic estate, such partnership, the trustee of such trust, or the executor of such estate (as the case may be) shall be required to deduct and withhold under subsection (a) a tax equal to 28 percent of the gain realized to the extent such gain—

"(A) is allocable to a foreign person who is a partner or beneficiary of such partnership, trust, or estate, or

"(B) is allocable to a portion of the trust treated as owned by a foreign person under subpart E of part I of subchapter J."

(B) Effective date.*—The amendment made by subparagraph (A) shall apply to dispositions after the day 30 days after the date of the enactment of this Act.*

(5) Distributions by domestic corporations to foreign shareholder.*—Paragraph (3) of section 1445(e) (relating to distributions by certain domestic corporations to foreign shareholders) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply if, as of the date of the distribution, interests in such corporation are not United States real property interests by reason of section 897(c)(1)(B)."*

(6) Certain taxable distributions.*—Paragraph (4) of section 1445(e) (relating to taxable distributions by domestic or foreign partnerships, trusts, or estates) is amended by striking out "section 897(g)" and inserting in lieu thereof "section 897".*

(7) Payment of tax.*—Subsection (d) of section 6039C (relating to special rule for United States interests and Virgin Islands interests) is amended by striking out "subject to tax under section 897(a)" and inserting in lieu thereof "subject to tax under section 897(a) (and any person required to withhold tax under section 1445)".*

(8) Payments through 1 or more entities.*—Paragraph (6) of section 1445(e) (relating to regulations) is amended by inserting before the period at the end thereof the following: "and regulations for the application of this subsection in the case of payments through 1 or more entities".*

(9) Conforming amendments to section 6652(g).*—*

(A) Paragraph (1) of section 6652(g) (relating to returns, etc., required under section 6039C) is amended to read as follows:

"(1) In general.*—In the case of each failure to make a return required by section 6039C which contains the information required by such section on the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not to willful neglect, the amount determined under paragraph (2) shall be paid (upon notice and demand by the Secretary and in the same manner as tax) by the person failing to make such return."*

(B) Paragraph (3) of section 6652(g) is amended to read as follows:

"(3) Limitation.*—The amount determined under paragraph (2) with respect to any person for failing to meet the requirements of section 6039C for any calendar year shall not exceed the lesser of—*

"(A) $25,000, or

"(B) 5 percent of the aggregate of the fair market value of the United States real property interests owned by such person at any time during such year.

For purposes of the preceding sentence, fair market value shall be determined as of the end of the calendar year (or, in the case *of any property disposed of during the calendar year, as of the date of such disposition)."*

(C) The subsection heading for subsection (g) of section 6652 is amended by striking out ", Etc.,".

(g) Amendments Related to Section 131 of the Act.—

(1) Subsection (f) of section 367 (relating to transitional rule) is hereby repealed.

(2) Paragraph (1) of section 7482(b) (relating to venue) is amended by striking out "section 7428, 7476, or 7477" and inserting in lieu thereof "section 7428 or 7476".

(3) Paragraph (8) of section 6501(c) (relating to failure to notify the Secretary under section 6038B) is amended—

(A) by striking out "subsection (a) or (d)" and inserting in lieu thereof "subsection (a), (d), or (e)", and

(B) by striking out "exchange" each place it appears and inserting in lieu thereof "exchange or distribution".

(4)(A) Subsection (a)(1) of section 367 (relating to foreign corporations) is amended by striking out "355,".

(B) Subsection (e) of section 367 (relating to treatment of liquidations under section 336) is amended—

(i) by striking out "described in section 336" and inserting in lieu thereof "described in section 336 or 355 (or so much of section 356 as relates to section 355)", and

(ii) by striking out "Liquidations Under Section 366" in the subsection heading and inserting in lieu thereof "Distributions Described in Section 336 or 355".

(h) Amendments Related to Section 132 of the Act.—

(1) Subsection (c) of section 552 (relating to certain dividends and interest not taken into account) is amended by adding at the end thereof the following new sentence:

"For purposes of the preceding sentence, the term 'related person' has the meaning given such term by section 954(d)(3) (determined by substituting 'foreign personal holding company' for 'controlled foreign corporation' each place it appears)."

(2) Paragraph (1) of section 551(f) (relating to stock held through foreign entity) is amended by striking out "United States shareholder" and inserting in lieu thereof "United States shareholder or an estate or trust which is a foreign estate or trust".

(i) Amendments Related to Section 133 of the Act.—

(1) Subparagraph (B) of section 1248(i)(1) (relating to treatment of certain indirect transfers) is amended by striking out "in redemption of his stock" and inserting in lieu thereof "in redemption or liquidation (whichever is appropriate)".

(2) Clause (iii) of section 133(d)(3)(B) of the Tax Reform Act of 1984 (relating to amendments related to section 1248) is amended by striking out "180 days after the date of the enactment of this Act" and inserting in lieu thereof "the date which is 1 year after the date of the enactment of the Tax Reform Act of 1985".

(j) Amendments Related to Section 136 of the Act.—

(1) Collection of tax.—Subsection (b) of section 269B (relating to stapled entities) is amended by inserting before the period at the end thereof the following: "and regulations providing that any tax imposed on the foreign corporation referred to in

subsection (a)(1) may, if not paid by such corporation, be collected from the domestic corporation referred to in such subsection or the shareholders of such foreign corporation".

(2) EXCEPTION WHERE CORPORATIONS OWNED BY FOREIGN PERSONS.—Section 269B is amended by adding at the end thereof the following new subsection:

"(e) SUBSECTION (a)(1) NOT TO APPLY IN CERTAIN CASES.—

"(1) IN GENERAL.—Subsection (a)(1) shall not apply if it is established to the satisfaction of the Secretary that the domestic corporation and the foreign corporation referred to in such subsection are foreign owned.

"(2) FOREIGN OWNED.—For purposes of paragraph (1), a corporation is foreign owned if less than 50 percent of—

"(A) the total combined voting power of all classes of stock of such corporation entitled to vote, and

"(B) the total value of the stock of the corporation,

is held directly (or indirectly through applying paragraphs (2) and (3) of section 958(a) and paragraph (4) of section 318(a)) by United States persons (as defined in section 7701(a)(30))."

(k) AMENDMENT RELATED TO SECTION 137 OF THE ACT.—Subsection (e) of section 954 (defining foreign base company services income) is amended to read as follows:

"(e) FOREIGN BASE COMPANY SERVICES INCOME.—

"(1) IN GENERAL.—For purposes of subsection (a)(3), the term 'foreign base company services income' means income (whether in the form of compensation, commissions, fees, or otherwise) derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which—

"(A) are performed for or on behalf of any related person (within the meaning of subsection (d)(3)), and

"(B) are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

"(2) EXCEPTION.—Paragraph (1) shall not apply to income derived in connection with the performance of services which are directly related to—

"(A) the sale or exchange by the controlled foreign corporation of property manufactured, produced, grown, or extracted by it and which are performed before the time of the sale or exchange, or

"(B) an offer or effort to sell or exchange such property.

"(3) TREATMENT OF CERTAIN INSURANCE CONTRACTS.—For purposes of paragraph (1), in the case of any services performed with respect to any policy of insurance or reinsurance with respect to which the primary insured is a related person (within the meaning of section 864(d)(4))—

"(A) such primary insured shall be treated as a related person for purposes of paragraph (1)(A) (whether or not the requirements of subsection (d)(3) are met),

"(B) such services shall be treated as performed in the country within which the insured hazards, risks, losses, or liabilities occur, and

"(C) except as otherwise provided in regulations by the Secretary, rules similar to the rules of section 953(b) shall be applied in determining the income from such services."

(l) AMENDMENTS RELATED TO SECTION 138 OF THE ACT.—

(1) Clause (i) of section 7701(b)(4)(E) (relating to limitation of teachers and trainees) is amended by adding at the end thereof the following new sentence: "In the case of an individual all of whose compensation is described in section 872(b)(3), the preceding sentence shall be applied by substituting '4 calendar years' for '2 calendar years'."

(2) Subparagraph (A) of section 7701(b)(1) is amended—

(A) by striking out "the requirements of clause (i) or (ii)" and inserting in lieu thereof "the requirements of clause (i), (ii), or (iii)", and

(B) by adding at the end thereof the following new clause:

"(iii) FIRST YEAR ELECTION.—Such individual makes the election provided in paragraph (4)."

(3) Subparagraph (A) of section 7701(b)(2) is amended by adding at the end thereof the following new clause:

"(iv) RESIDENCY STARTING DATE FOR INDIVIDUALS MAKING FIRST YEAR ELECTION.—In the case of an individual who makes the election provided by paragraph (4) with respect to any calendar year, the residency starting date shall be the 1st day during such calendar year on which the individual is treated as a resident of the United States under that paragraph."

(4) Subsection (b) of section 7701 is amended by redesignating paragraphs (4), (5), (6), (7), (8), (9), and (10) as paragraphs (5), (6), (7), (8), (9), (10), and (11), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) FIRST-YEAR ELECTION.—

"(A) An alien individual shall be deemed to meet the requirements of this subparagraph if such individual—

"(i) is not a resident of the United States under clause (i) or (ii) of paragraph (1)(A) with respect to a calendar year (hereinafter referred to as the 'election year'),

"(ii) was not a resident of the United States under paragraph (1)(A) with respect to the calendar year immediately preceding the election year,

"(iii) is a resident of the United States under clause (ii) of paragraph (1)(A) with respect to the calendar year immediately following the election year, and

"(iv) is both—

"(I) present in the United States for a period of at least 31 consecutive days in the election year, and

"(II) present in the United States during the period beginning with the first day of such 31-day period and ending with the last day of the election year (hereinafter referred to as the 'testing period') for a number of days equal to or exceeding 75 percent of the number of days in the testing period

(provided that an individual shall be treated for purposes of this subclause as present in the United States for a number of days during the testing period not exceeding 5 days in the aggregate, notwithstanding his absence from the United States on such days).

"(B) An alien individual who meets the requirements of subparagraph (A) shall, if he so elects, be treated as a resident of the United States with respect to the election year.

"(C) An alien individual who makes the election provided by subparagraph (B) shall be treated as a resident of the United States for the portion of the election year which begins on the 1st day of the earliest testing period during such year with respect to which the individual meets the requirements of clause (iv) of subparagraph (A).

"(D) The rules of subparagraph (D)(i) of paragraph (3) shall apply for purposes of determining an individual's presence in the United States under this paragraph.

"(E) An election under subparagraph (B) shall be made on the individual's tax return for the election year, provided that such election may not be made before the individual has met the substantial presence test of paragraph (3) with respect to the calendar year immediately following the election year.

"(F) An election once made under subparagraph (B) remains in effect for the election year, unless revoked with the consent of the Secretary."

(5)(A) Section 7701(b)(4)(A) (defining exempt individual) is amended by striking "or" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", or" and by adding after clause (iii) the following new clause:

"(iv) a professional athlete who is temporarily in the United States to compete in a charitable sports event described in section 274(k)(2)."

(B) The amendments made by this paragraph shall apply to periods after the date of the enactment of this Act.

SEC. 1811. AMENDMENTS RELATED TO REPORTING, PENALTY, AND OTHER PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 145 OF THE ACT.—

(1) Section 6050H (relating to returns relating to mortgage interest received in trade or business from individuals) is amended by adding at the end thereof the following new subsection:

"(g) SPECIAL RULES FOR COOPERATIVE HOUSING CORPORATIONS.—For purposes of subsection (a), an amount received by a cooperative housing corporation from a tenant-stockholder shall be deemed to be interest received on a mortgage in the course of a trade or business engaged in by such corporation, to the extent of the tenant-stockholder's proportionate share of interest described in section 216(a)(2). Terms used in the preceding sentence shall have the same meanings as when used in section 216."

(2) Paragraph (2) of section 145(d) of the Tax Reform Act of 1984 is amended by striking out "section 6652" and inserting in lieu thereof "section 6676".

(b) Amendments Related to Section 149 of the Act.—

(1) Return of partnership income.—

(A) In general.—Section 6031 (relating to return of partnership income) is amended—

(i) by inserting "or who holds an interest in such partnership as a nominee for another person" in subsection (b) after "who is a partner", and

(ii) by adding at the end thereof, the following new subsection:

"(c) Nominee Reporting.—Any person who holds an interest in a partnership as a nominee for another person—

"(1) shall furnish to the partnership, in the manner prescribed by the Secretary, the name and address of such other person, and any other information for such taxable year as the Secretary may by form and regulation prescribe, and

"(2) shall furnish in the manner prescribed by the Secretary such other person the information provided by such partnership under subsection (b)."

(B) Effective date.—The amendments made by this subsection shall apply to partnership taxable years beginning after the date of the enactment of this Act.

(2) Returns relating to certain partnership interests.—Paragraph (2) of section 6050K(c) (relating to requirement that transferor notify partnership) is amended by striking out "this subsection" and inserting in lieu thereof "this section".

(c) Amendments Related to Section 150 of the Act.—

(1) Paragraph (3) of section 6678(a) (relating to failure to furnish certain statements) is amended by striking out "or" at the end of subparagraph (E), by adding "or" at the end of subparagraph (F), and by inserting after subparagraph (F) the following new subparagraph:

"(G) section 6045(d) (relating to statements required in the case of certain substitute payments),".

(2) Clause (ii) of section 6652(a)(3)(A) (relating to penalty in the case of intentional disregard) is amended by inserting "(other than by subsection (d) of such section)" after "section 6045".

(d) Amendment Related to Section 155 of the Act.—Section 6660 (relating to addition of tax in the case of valuation understatement for purposes of estate or gift taxes) is amended by adding at the end thereof the following new subsection:

"(f) Underpayment Defined.—For purposes of this section, the term 'underpayment' has the meaning given to such term by section 6653(c)(1)."

(e) Amendment Related to Section 157 of the Act.—Paragraph (3) of section 7502(e) is amended by striking out "the tax" and inserting in lieu thereof "any tax".

SEC. 1812. AMENDMENTS RELATED TO MISCELLANEOUS PROVISIONS.

(a) Amendments Related to Section 171 of the Act.—

(1) Subsection (a) of section 111 (relating to recovery of tax benefit items) is amended by striking out "did not reduce income subject to tax" and inserting in lieu thereof "did not reduce the amount of tax imposed by this chapter".

(2) Subsection (c) of section 111 (relating to treatment of carryovers) is amended by striking out "reducing income subject to tax or reducing tax imposed by this chapter, as the case may be" and inserting in lieu thereof "reducing tax imposed by this chapter".

(3) Paragraph (12) of section 381(c) (relating to recovery of bad debts, prior taxes, or delinquency amounts) is amended to read as follows:

"(12) Recovery of tax benefit items.—If the acquiring corporation is entitled to the recovery of any amounts previously deducted by (or allowable as credits to) the distributor or transferor corporation, the acquiring corporation shall succeed to the treatment under section 111 which would apply to such amounts in the hands of the distributor or transferor corporation."

(4) Paragraph (2) of section 1351(d) is amended by striking out "relating to recovery of bad debts, etc." and inserting in lieu thereof "relating to recovery of tax benefit items".

(5) Paragraph (3) of section 1398(g) is amended to read as follows:

"(3) Recovery of tax benefit items.—Any amount to which section 111 (relating to recovery of tax benefit items) applies."

(b) Amendments Related to Section 172 of the Act.—

(1) Coordination of section 7872 with taxes on private foundations.—Subparagraph (B) of section 4941(d)(2) (defining self-dealing) is amended by striking out "without interest or other charge" and inserting in lieu thereof "without interest or other charge (determined without regard to section 7872)".

(2) Coordination with withholding.—Paragraph (9) of section 7872(f) (relating to no withholding) is amended to read as follows:

"(9) No withholding.—No amount shall be withheld under chapter 24 with respect to—

"(A) any amount treated as transferred or retransferred under subsection (a), and

"(B) any amount treated as received under subsection (b)."

(3) Definition of demand loan.—Paragraph (5) of section 7872(f) (defining demand loan) is amended to read as follows:

"(5) Demand loan.—The term 'demand loan' means any loan which is payable in full at any time on the demand of the lender. Such term also includes (for purposes other than determining the applicable Federal rate under paragraph (2)) any loan if the benefits of the interest arrangements of such loan are not transferable and are conditioned on the future performance of substantial services by an individual. To the extent provided in regulations, such term also includes any loan with an indefinite maturity."

(4) Clarification of applicable federal rate.—Subparagraph (B) of section 7872(f)(2) (defining applicable Federal rate) is amended by inserting ", compounded semiannually" immediately before the period at the end thereof.

(5) Certain Israel bonds not subject to rules relating to below-market loans.—Section 7872 of the Internal Reve-

nue Code of 1954 (relating to treatment of loans with below-market interest rates) shall not apply to any obligation issued by Israel if—

(A) the obligation is payable in United States dollars, and

(B) the obligation bears interest at an annual rate of not less than 4 percent.

(c) AMENDMENTS RELATED TO SECTION 174 OF THE ACT.—

(1) TREATMENT OF FOREIGN PERSONS.—Subsection (a) of section 267 is amended by adding at the end thereof the following new paragraph:

"(3) PAYMENTS TO FOREIGN PERSONS.—The Secretary shall by regulations apply the matching principle of paragraph (2) in cases in which the person to whom the payment is to be made is not a United States person."

(2) TREATMENT OF CERTAIN SALES OF INVENTORY EXPANDED.—Subparagraph (B) of section 267(f)(3) (relating to loss deferral rules not to apply in certain cases) is amended by inserting "(or persons described in subsection (b)(10))" after "same controlled group".

(3) TREATMENT OF CERTAIN RELATED PARTNERSHIPS.—

(A) Effective with respect to sales or exchanges after September 27, 1985, paragraphs (1)(A) and (2)(A) of section 707(b) (relating to certain sales or exchanges of property with respect to controlled partnerships) are each amended by striking out "a partner" and inserting in lieu thereof "a person".

(B) Paragraph (1) of section 707(b) is amended by adding at the end thereof the following new sentence: "For purposes of section 267(a)(2), partnerships described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b)."

(C) Subsection (e) of section 267 is amended by adding at the end thereof the following new paragraph:

"(6) CROSS REFERENCE.—

"For additional rules relating to partnerships, see section 707(b)."

(4) CLERICAL AMENDMENTS.—

(A) Paragraph (12) of section 267(b) (defining related persons) is amended by striking out "same persons owns" and inserting in lieu thereof "same persons own".

(B) Subparagraph (B) of section 178(b)(2) (defining related persons) is amended by inserting before the period "and subsection (f)(1)(A) of such section shall not apply".

(C) Clause (ii) of section 936(h)(3)(D) (defining related person) is amended to read as follows:

"(ii) SPECIAL RULE.—For purposes of clause (i), section 267(b) and section 707(b)(1) shall be applied by substituting '10 percent' for '50 percent'."

(5) EXCEPTION FOR CERTAIN INDEBTEDNESS.—Clause (i) of section 174(c)(3)(A) of the Tax Reform Act of 1984 shall be applied by substituting "December 31, 1983" for "September 29, 1983" in the case of indebtedness which matures on January 1, 1999, the payments on which from January 1989 through November

1993 equal U/L plus $77,600, the payments on which from December 1993 to maturity equal U/L plus $50,100, and which accrued interest at 13.75 percent through December 31, 1989.

(d) AMENDMENTS RELATED TO SECTION 177 OF THE ACT.—

(1) CLARIFICATION OF TREATMENT OF DIVIDENDS PAID BY FEDERAL HOME LOAN BANKS.—

(A) Subparagraph (B) of section 246(a)(2) (relating to certain dividends of Federal home loan banks) is amended—

(i) by striking out "For purposes of subparagraph (A), in" and inserting in lieu thereof "In", and

(ii) by striking out subclause (II) of clause (i) and inserting in lieu thereof the following:

"(II) which were not previously treated as distributed under subparagraph (A) or this subparagraph, bears to".

(B) Paragraph (2) of section 246(a) (relating to subsection not to apply to certain dividends of Federal Home Loan Banks) is amended by redesignating subparagraph (C) as subparagraph (D) and by inserting after subparagraph (B) the following new subparagraph:

"(C) COORDINATION WITH SECTION 243.—To the extent that paragraph (1) does not apply to any dividend by reason of subparagraph (A) or (B) of this paragraph, the requirement contained in section 243(a) that the corporation paying the dividend be subject to taxation under this chapter shall not apply."

(C) Subparagraph (D) of section 246(a)(2) (as redesignated by subparagraph (B)) is amended by adding at the end thereof the following new clause:

"(iv) EARNINGS AND PROFITS.—The earnings and profits of any FHLB for any taxable year shall be treated as equal to the sum of—

"(I) any dividends received by the FHLB from the FHLMC during such taxable year, and

"(II) the total earnings and profits (determined without regard to dividends described in subclause (I)) of the FHLB as reported in its annual financial statement prepared in accordance with section 20 of the Federal Home Loan Bank Act (12 U.S.C. 1440)."

(2) CLARIFICATION OF EFFECTIVE DATE.—Paragraph (4) of section 177(d) of the Tax Reform Act of 1984 (relating to effective dates) is amended to read as follows:

"(4) CLARIFICATION OF EARNINGS AND PROFITS OF FEDERAL HOME LOAN MORTGAGE CORPORATION.—

"(A) TREATMENT OF DISTRIBUTION OF PREFERRED STOCK, ETC.—For purposes of the Internal Revenue Code of 1954, the distribution of preferred stock by the Federal Home Loan Mortgage Corporation during December of 1984, and the other distributions of such stock by Federal Home Loan Banks during January of 1985, shall be treated as if they were distributions of money equal to the fair market value of the stock on the date of the distribution by the Federal Home Loan Banks (and such stock shall be treated as if it

were purchased with the money treated as so distributed). No deduction shall be allowed under section 243 of the Internal Revenue Code of 1954 with respect to any dividend paid by the Federal Home Loan Mortgage Corporation out of earnings and profits accumulated before January 1, 1985.

"(B) Section 246(a) not to apply to distributions out of earnings and profits accumulated during 1985.—Subsection (a) of section 246 of the Internal Revenue Code of 1954 shall not apply to any dividend paid by the Federal Home Loan Mortgage Corporation during 1985 out of earnings and profits accumulated after December 31, 1984."

(e) Amendments Related to Section 179 of the Act.—

(1) Clarification of definition of passenger automobile.—

(A) Section 280F.—Clause (ii) of section 280F(d)(5)(A) (defining passenger automobile) is amended by striking out "gross vehicle weight" and inserting in lieu thereof "unloaded gross vehicle weight".

(B) Gas guzzler tax.—

(i) Clause (ii) of section 4064(b)(1)(A) (defining passenger automobile) is amended by striking out "gross vehicle weight" and inserting in lieu thereof "unloaded gross vehicle weight".

(ii) Paragraph (5) of section 4064(b) (defining manufacturer) is amended to read as follows:

"(5) Manufacturer.—

"(A) In general.—The term 'manufacturer' includes a producer or importer.

"(B) Exception for certain small manufacturers.—A person shall not be treated as the manufacturer of any automobile if—

"(i) such person would (but for this subparagraph) be so treated solely by reason of lengthening an existing automobile, and

"(ii) such person is a small manufacturer (as defined in subsection (d)(4)) for the model year in which such lengthening occurs."

(iii) The amendments made by clauses (i) and (ii) shall take effect as if included in the amendments made by section 201 of Public Law 95-618; except that the amendment made by clause (i) shall not apply to any station wagon if—

(I) such station wagon is originally equipped with more than 6 seat belts,

(II) such station wagon was manufactured before November 1, 1985, and

(III) such station wagon is of the 1985 or 1986 model year.

(C) Trucks and vans.—Subparagraph (A) of section 280F(d)(5) is amended by adding at the end thereof the following new sentence:

"In the case of a truck or van, clause (ii) shall be applied by substituting 'gross vehicle weight' for 'unloaded gross vehicle weight'."

(2) DEDUCTIONS OF EMPLOYEE FOR USE OF LISTED PROPERTY.—Subparagraph (A) of section 280F(d)(3) (relating to deductions of employee) is amended by striking out "recovery deduction allowable to the employee" and inserting in lieu thereof "recovery deduction allowable to the employee (or the amount of any deduction allowable to the employee for rentals or other payments under a lease of listed property)".

(3) TREATMENT OF CERTAIN COMPUTERS.—Subparagraph (B) of section 280F(d)(4) (relating to exception for certain computers) is amended by striking out "at a regular business establishment" and inserting in lieu thereof "at a regular business establishment and owned or leased by the person operating such establishment".

(4) EXCEPTION FOR PROPERTY USED IN BUSINESS OF TRANSPORTING PERSONS OR PROPERTY.—Paragraph (4) of section 280F(d) (defining listed property) is amended by adding at the end thereof the following new subparagraph:

> *"(C) EXCEPTION FOR PROPERTY USED IN BUSINESS OF TRANSPORTING PERSONS OR PROPERTY.—Except to the extent provided in regulations, clause (ii) of subparagraph (A) shall not apply to any property substantially all of the use of which is in a trade or business of providing to unrelated persons services consisting of the transportation of persons or property for compensation or hire."*

(5) CLERICAL AMENDMENT.—Paragraph (2) of section 280F(d) (relating to subsequent depreciation deductions reduced for deductions allocable to personal use) is amended by striking out "is not use described in" and inserting in lieu thereof "is use described in".

CHAPTER 2—AMENDMENTS RELATED TO TITLE II OF THE ACT

SEC. 1821. AMENDMENTS RELATED TO SECTION 211 OF THE ACT.

(a) CERTAIN AMOUNTS NOT LESS THAN SURRENDER VALUE OF CONTRACT.—Subsection (c) of section 807 (relating to rules for certain reserves) is amended by adding at the end thereof the following new sentence: "In no case shall the amount determined under paragraph (3) for any contract be less than the net surrender value of such contract."

(b) CLARIFICATION OF DEFINITION OF EXCESS INTEREST.—Subparagraph (B) of section 808(d)(1) (defining excess interest) is amended to read as follows:

> *"(B) in excess of interest determined at the prevailing State assumed rate for such contract."*

(c) COORDINATION OF 1984 FRESH-START ADJUSTMENT WITH CERTAIN ACCELERATIONS OF POLICYHOLDER DIVIDENDS DEDUCTIONS.—Section 808 (relating to policyholder dividends deduction) is amended by adding at the end thereof the following new subsection:

"(f) Coordination of 1984 Fresh-Start Adjustment With Acceleration of Policyholder Dividends Deduction Through Change in Business Practice.—

"(1) In general.—The amount determined under paragraph (1) of subsection (c) for the year of change shall (before any reduction under paragraph (2) of subsection (c)) be reduced by so much of the accelerated policyholder dividends deduction for such year as does not exceed the 1984 fresh-start adjustment for policyholder dividends (to the extent such adjustment was not previously taken into account under this subsection).

"(2) Year of change.—For purposes of this subsection, the term 'year of change' means the taxable year in which the change in business practices which results in the accelerated policyholder dividends deduction takes effect.

"(3) Accelerated policyholder dividends deduction defined.—For purposes of this subsection, the term 'accelerated policyholder dividends deduction' means the amount which (but for this subsection) would be determined for the taxable year under paragraph (1) of subsection (c) but which would have been determined (under such paragraph) for a later taxable year under the business practices of the taxpayer as in effect at the close of the preceding taxable year.

"(4) 1984 fresh-start adjustment for policyholder dividends.—For purposes of this subsection, the term '1984 fresh-start adjustment for policyholder dividends' means the amounts held as of December 31, 1983, by the taxpayer as reserves for dividends to policyholders under section 811(b) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1984) other than for dividends which accrued before January 1, 1984. Such amounts shall be properly reduced to reflect the amount of previously nondeductible policyholder dividends (as determined under section 809(f) as in effect on the day before the date of the enactment of the Tax Reform Act of 1984).

"(5) Separate application with respect to lines of business.—This subsection shall be applied separately with respect to each line of business of the taxpayer.

"(6) Subsection not to apply to mere change in dividend amount.—This subsection shall not apply to a mere change in the amount of policyholder dividends.

"(7) Subsection not to apply to policies issued after December 31, 1983.—

"(A) In general.—This subsection shall not apply to any policyholder dividend paid or accrued with respect to a policy issued after December 31, 1983.

"(B) Exchanges of substantially similar policies.—For purposes of subparagraph (A), any policy issued after December 31, 1983, in exchange for a substantially similar policy issued on or before such date shall be treated as issued before January 1, 1984. A similar rule shall apply in the case of a series of exchanges.

"(8) Subsection to apply to policies provided under employee benefit plans.—This subsection shall not apply to any policyholder dividend paid or accrued with respect to a group

policy issued in connection with a plan to provide welfare benefits to employees (within the meaning of section 419(e)(2)).”

(d) Clarification of Equity Base.—Paragraph (2) of section 809(b) (defining equity base) is amended by adding at the end thereof the following new sentence: “No item shall be taken into account more than once in determining equity base.”

(e) Definition of 50 Largest Stock Companies.—

(1) In general.—Subparagraph (C) of section 809(d)(4) (defining 50 largest stock companies) is amended by striking out the last sentence and inserting in lieu thereof the following:

“the Secretary—

“(i) shall, for purposes of determining the base period stock earnings rate, exclude from the group determined under the preceding sentence any company which had a negative equity base at any time during 1981, 1982, or 1983,

“(ii) shall exclude from such group for any calendar year any company which has a negative equity base, and

“(iii) may by regulations exclude any other company which otherwise would have been included in such group if the inclusion of the excluded company or companies would, by reason of the small equity base of such company, seriously distort the stock earnings rate.

The aggregate number of companies excluded by the Secretary under clause (iii) shall not exceed the excess of 2 over the number of companies excluded under clause (ii).”

“(2) Only domestic companies taken into account.—Section 809 is amended—

“(A) by striking out “largest stock life insurance companies” in subsection (d)(4)(C) and inserting in lieu thereof “largest domestic stock life insurance companies”, and

“(B) by striking out “mutual life insurance companies” in subsection (e)(1) and inserting in lieu thereof “domestic mutual life insurance companies”.

(f) Clarification of Statement Gain or Loss From Operations.—Paragraph (1) of section 809(g) (defining statement gain or loss from operations) is amended by striking out so much of such paragraph as precedes subparagraph (B) and inserting in lieu thereof the following:

“(1) Statement gain or loss from operations.—The term ‘statement gain or loss from operations’ means the net gain or loss from operations required to be set forth in the annual statement, determined without regard to Federal income taxes, and—

“(A) determined by substituting for the amount shown for policyholder dividends the amount of deduction for policyholder dividends determined under section 808 (without regard to section 808(c)(2)),”.

(g) Differential Earnings Rate Which May Be Used for Purposes of Estimated Tax Payments.—Subsection (c) of section 809 (defining differential earnings rate) is amended by adding at the end thereof the following new paragraph:

"(3) Coordination with estimated tax payments.—For purposes of applying section 6655 with respect to any installment of estimated tax, the amount of tax shall be determined by using the lesser of—

"(A) the differential earnings rate of the second tax year preceding the taxable year for which the installment is made, or

"(B) the differential earnings rate for the taxable year for which the installment is made."

(h) Recomputation of Differential Earnings Amount Not Taken Into Account for Purposes of Estimated Tax.—Subsection (f) of section 809 (relating to recomputation in subsequent year) is amended by adding at the end thereof the following new paragraph:

"(5) Subsection not to apply for purposes of estimated tax.—Section 6655 shall be applied to any taxable year without regard to any adjustments under this subsection for such year."

(i) Amendments Related to Proration Formulas.—

(1) Paragraph (2) of section 812(b) is amended—

(A) by striking out "the prevailing State assumed rate" in subparagraph (A) and inserting in lieu thereof "the prevailing State assumed rate or, where such rate is not used, another appropriate rate",

(B) by striking out "and" at the end of subparagraph (B),

(C) by striking out the period at the end of subparagraph (C) and inserting in lieu thereof ", and", and

(D) by adding at the end thereof the following new subparagraph:

"(D) interest on amounts left on deposit with the company."

(2) Subparagraph (B) of section 812(b)(3) (relating to gross investment income's proportionate share of policyholder dividends) is amended—

(A) by striking out "(including tax-exempt interest)" in clause (ii), and

(B) by adding at the end thereof the following new sentence:

"For purposes of subparagraph (B)(ii), life insurance gross income shall be determined by including tax-exempt interest and by applying section 807(a)(2)(B) as if it did not contain clause (i) thereof."

(3) Subsection (c) of section 812 (defining net investment income) is amended to read as follows:

"(c) Net Investment Income.—For purposes of this section, the term 'net investment income' means—

"(1) except as provided in paragraph (2), 90 percent of gross investment income; or

"(2) in the case of gross investment income attributable to assets held in segregated asset accounts under variable contracts, 95 percent of gross investment income."

(4) Section 812 is amended by adding at the end thereof the following new subsection:

"(g) Treatment of Interest Partially Tax-Exempt Under Section 133.—For purposes of this section and subsections (a) and

(b) of section 807, the terms 'gross investment income' and 'tax-exempt interest' shall not include any interest received with respect to a securities acquisition loan (as defined in section 133(b)). Such interest shall not be included in life insurance gross income for purposes of subsection (b)(3)."

(j) Treatment of Foreign Life Insurance Companies.—Paragraph (1) of section 813(a) (relating to adjustment where surplus held in United States is less than specified minimum) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall be applied before computing the amount of the special life insurance company deduction and the small life insurance company deduction, and any increase under the preceding sentence shall be treated as gross investment income."

(k) Treatment of Certain Distributions to Shareholders From Pre-1984 Policyholders Surplus Account.—

(1) Subsection (f) of section 815 (relating to other rules applicable to policyholders surplus account continued) is amended by striking out "section 6501(c)(6)" and inserting in lieu thereof "sections 819(b), 6501(c)(6)".

(2) Subsection (a) of section 815 is amended by adding at the end thereof the following new sentence:

"For purposes of the preceding sentence, the term 'indirect distribution' shall not include any bona fide loan with arms-length terms and conditions."

(3) In the case of any loan made before March 1, 1986 (other than a loan which is renegotiated, extended, renewed, or revised after February 28, 1986), which does not meet the requirements of the last sentence of section 815(a) of the Internal Revenue Code of 1954 (as added by paragraph (2)), the amount of the indirect distribution for purposes of such section 815(a) shall be the foregone interest on the loan (determined by using the lowest rate which would have met the arms-length requirements of such sentence for such a loan).

(l) Treatment of Deficiency Reserves.—Section 816 (defining life insurance company) is amended by adding at the end thereof the following new subsection:

"(h) Treatment of Deficiency Reserves.—For purposes of this section and section 813(a)(4)(B), the terms 'life insurance reserves' and 'total reserves' shall not include deficiency reserves."

(m) Treatment of Certain Nondiversified Contracts.—

(1) Subsection (h) of section 817 (relating to treatment of certain nondiversified contracts) is amended by striking out paragraphs (3) and (4) and inserting in lieu thereof the following:

"(3) Special rule for investments in United States obligations.—To the extent that any segregated asset account with respect to a variable life insurance contract is invested in securities issued by the United States Treasury, the investments made by such account shall be treated as adequately diversified for purposes of paragraph (1).

"(4) Look-through in certain cases.—For purposes of this subsection, if all of the beneficial interests in a regulated investment company or in a trust are held by 1 or more—

"(A) insurance companies (or affiliated companies) in their general account or in segregated asset accounts, or

"(B) *fund managers (or affiliated companies) in connection with the creation or management of the regulated investment company or trust,*

the diversification requirements of paragraph (1) shall be applied by taking into account the assets held by such regulated investment company or trust.

"(5) *INDEPENDENT INVESTMENT ADVISORS PERMITTED.—Nothing in this subsection shall be construed as prohibiting the use of independent investment advisors.*"

(2) Paragraph (1) of section 817(h) is amended by striking out the last sentence.

(n) TREATMENT OF CERTAIN DEFERRED COMPENSATION PLANS.—Subparagraph (A) of section 818(a)(6) (defining pension plan contract) is amended to read as follows:

"(A) *a governmental plan (within the meaning of section 414(d)) or an eligible State deferred compensation plan (within the meaning of section 457(b)), or*".

(o) DIVIDENDS WITHIN AFFILIATED GROUP.—Subsection (e) of section 818 (relating to special rule for consolidated returns) is amended to read as follows:

"(e) *SPECIAL RULES FOR CONSOLIDATED RETURNS.—*

"(1) *ITEMS OF COMPANIES OTHER THAN LIFE INSURANCE COMPANIES.—If an election under section 1504(c)(2) is in effect with respect to an affiliated group for the taxable year, all items of the members of such group which are not life insurance companies shall not be taken into account in determining the amount of the tentative LICTI of members of such group which are life insurance companies.*

"(2) *DIVIDENDS WITHIN GROUP.—In the case of a life insurance company filing or required to file a consolidated return under section 1501 with respect to any affiliated group for any taxable year, any determination under this part with respect to any dividend paid by one member of such group to another member of such group shall be made as if such group was not filing a consolidated return.*"

(p) TREATMENT OF DIVIDENDS FROM SUBSIDIARIES, ETC.—Paragraph (4) of section 805(a) (relating to dividends received by company) is amended by redesignating subparagraph (D) as subparagraph (E) and by striking out subparagraph (C) and inserting in lieu thereof the following new subparagraphs:

"(C) *100 PERCENT DIVIDEND.—For purposes of subparagraph (A)—*

"(i) *IN GENERAL.—Except as provided in clause (ii), the term '100 percent dividend' means any dividend if the percentage used for purposes of determining the deduction allowable under section 243, 244, or 245(b) is 100 percent.*

"(ii) *TREATMENT OF DIVIDENDS FROM NONINSURANCE COMPANIES.—The term '100 percent dividend' does not include any distribution by a corporation which is not an insurance company to the extent such distribution is out of tax-exempt interest or out of dividends which are not 100 percent dividends (determined with the ap-*

plication of this clause as if it applies to distributions by all corporations including insurance companies).

"(D) SPECIAL RULES FOR CERTAIN DIVIDENDS FROM INSURANCE COMPANIES.—

"(i) IN GENERAL.—In the case of any 100 percent dividend paid to any life insurance company out of the earnings and profits for any taxable year beginning after December 31, 1983, of another life insurance company if—

"(I) the paying company's share determined under section 812 for such taxable year, exceeds

"(II) the receiving company's share determined under section 812 for its taxable year in which the dividend is received or accrued,

the deduction allowed under section 243, 244, or 245(b) (as the case may be) shall be reduced as provided in clause (ii).

"(ii) AMOUNT OF REDUCTION.—The reduction under this clause for a dividend is an amount equal to—

"(I) the portion of such dividend attributable to prorated amounts, multiplied by

"(II) the percentage obtained by subtracting the share described in subclause (II) of clause (i) from the share described in subclause (I) of such clause.

"(iii) PRORATED AMOUNTS.—For purposes of this subparagraph, the term 'prorated amounts' means tax-exempt interest and dividends other than 100 percent dividends.

"(iv) PORTION OF DIVIDEND ATTRIBUTABLE TO PRORATED AMOUNTS.—For purposes of this subparagraph, in determining the portion of any dividend attributable to prorated amounts—

"(I) any dividend by the paying corporation shall be treated as paid first out of earnings and profits for taxable years beginning after December 31, 1983, attributable to prorated amounts (to the extent thereof), and

"(II) by determining the portion of earnings and profits so attributable without any reduction for the tax imposed by this chapter.

"(v) SUBPARAGRAPH TO APPLY TO DIVIDENDS FROM OTHER INSURANCE COMPANIES.—Rules similar to the rules of this subsection shall apply in the case of 100 percent dividends paid by an insurance company which is not a life insurance company."

(q) SPECIAL RULE FOR APPLICATION OF HIGH SURPLUS MUTUAL RULES.—In the case of any mutual life insurance company—

(1) which was incorporated on February 23, 1888, and

(2) which acquired a stock subsidiary during 1982,

the amount of such company's excess equity base for purposes of section 809(i) of such Code shall, notwithstanding the last sentence of section 809(i)(2)(D), equal $175,000,000.

(r) Clerical Amendment.—Paragraph (3) of section 809(f) is amended by striking out "subsection (c)(2)" and inserting in lieu thereof "subsection (c)(1)(B)".

(s) Amendments Related to Section 807.—Subparagraph (C) of section 807(d)(5) is amended by adding at the end thereof the following: "When the Secretary by regulation changes the table applicable to a type of contract, the new table shall be treated (for purposes of subparagraph (B) and for purposes of determining the issue dates of contracts for which it shall be used) as if it were a new prevailing commissioner's standard table adopted by the twenty-sixth State as of a date (no earlier than the date the regulation is issued) specified by the Secretary."

(t) Amendment Related to Section 817.—

(1) Subsection (d) of section 817 is amended by adding at the end thereof the following new sentence: "Paragraph (3) shall be applied without regard to whether there is a guarantee, and obligations under such guarantee which exceed obligations under the contract without regard to such guarantee shall be accounted for as part of the company's general account."

(2) The amendment made by paragraph (1) shall apply—

(A) to contracts issued after December 31, 1986, and

(B) to contracts issued before January 1, 1987, if such contract was treated as a variable contract on the taxpayer's return.

SEC. 1822. AMENDMENTS RELATED TO SECTION 216 OF THE ACT.

(a) Clarification of Application of 10-Year Spread.—Subparagraph (C) of section 216(b)(3) of the Tax Reform Act of 1984 (relating to 10-year spread inapplicable where no 10-year spread under prior law) is amended by striking out "was required to have been taken into account" and inserting in lieu thereof "would have been required to be taken into account".

(b) Treatment of Certain Elections Under Section 818(c).—Subparagraph (B) of section 216(b)(4) of the Tax Reform Act of 1984 (relating to the elections under section 818(c) after September 27, 1983, not taken into account) is amended by striking out "Subparagraph (A)" and inserting in lieu thereof "Paragraph (3) and subparagraph (A) of this paragraph".

(c) Election Not To Have Reserves Recomputed.—

(1) Clause (ii) of section 216(c)(2)(A) of the Tax Reform Act of 1984 (relating to election with respect to contracts issued after 1983 and before 1989) is amended by striking out "$3,000,000" and inserting in lieu thereof "$3,000,000 (determined with regard to this paragraph)".

(2) Subparagraph (A) of section 216(c)(2) of the Tax Reform Act of 1984 is amended by striking out "be equal to" and all that follows down through the period at the end thereof and inserting in lieu thereof the following: "be equal to the greater of the statutory reserve for such contract (adjusted as provided in subparagraph (B)) or the net surrender value of such contract (as defined in section 807(e)(1) of the Internal Revenue Code of 1954)."

(3) Subparagraph (B) of section 216(c)(2) of the Tax Reform Act of 1984 is amended—

(A) by striking out "statutory reserves" and inserting in lieu thereof "opening and closing statutory reserves", and

(B) by striking out "under section 805(c)(1) of such Code" and inserting in lieu thereof "under the principles of section 805(c)(1) of such Code".

(d) SPECIAL RULE WHERE REINSURER NOT USING CALENDAR YEAR AS TAXABLE YEAR.—Subparagraph (A) of section 216(b)(3) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following: "For purposes of this subparagraph, if the reinsurer's taxable year is not a calendar year, the first day of the reinsurer's first taxable year beginning after December 31, 1983, shall be substituted for 'January 1, 1984' each place it appears."

(e) CLARIFICATION OF EFFECT OF FRESH START ON EARNINGS AND PROFITS.—Paragraph (1) of section 216(b) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new sentences: "The preceding sentence shall apply for purposes of computing the earnings and profits of any insurance company for its 1st taxable year beginning in 1984. The preceding sentence shall be applied by substituting '1985' for '1984' in the case of an insurance company which is a member of a controlled group (as defined in section 806(d)(3)), the common parent of which is

"(A) a company having its principal place of business in Alabama and incorporated in Delaware on November 29, 1979, or

"(B) a company having its principal place of business in Houston, Texas, and incorporated in Delaware on June 9, 1947."

(f) TREATMENT OF SECTION 818(c) ELECTIONS MADE BY CERTAIN ACQUIRED COMPANIES.—Paragraph (4) of section 216(b) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subparagraph:

"(C) SECTION 818(C) ELECTIONS MADE BY CERTAIN ACQUIRED COMPANIES.—

"(i) IN GENERAL.—If the case of any corporation—

"(I) which made an election under such section 818(c) before September 28, 1983, and

"(II) which was acquired in a qualified stock purchase (as defined in section 338(c) of the Internal Revenue Code of 1954) before December 31, 1983,

the fact that such corporation is treated as a new corporation under section 338 of such Code shall not result in the election described in clause (i) not applying to such new corporation.

"(ii) TIME FOR MAKING SECTION 818(C) OR 338 ELECTION.—In the case of any corporation described in clause (i), the time for making an election under section 818(c) of such Code (with respect to the first taxable year of the corporation beginning in 1983 and ending after September 28, 1983), or making an election under section 338 of such Code with respect to the qualified stock purchase described in clause (i)(II), shall not expire before the close of the 60th day after the date of the enactment of the Tax Reform Act of 1986.

"(iii) STATUTE OF LIMITATIONS.—In the case of any such election under section 818(c) or 338 of such Code which would not have been timely made but for clause (ii), the period for assessing any deficiency attributable to such election (or for filing claim for credit or refund of any overpayment attributable to such election) shall not expire before the date 2 years after the date of the enactment of this Act.

SEC. 1823. AMENDMENT RELATED TO SECTION 217 OF THE ACT.

Subsection (n) of section 217 of the Tax Reform Act of 1984 (relating to special rule for companies using net level reserve method for noncancellable accident and health insurance contracts) is amended to read as follows:

"(n) SPECIAL RULE FOR COMPANIES USING NET LEVEL RESERVE METHOD FOR NONCANCELLABLE ACCIDENT AND HEALTH INSURANCE CONTRACTS.—A company shall be treated as meeting the requirements of section 807(d)(3)(A)(iii) of the Internal Revenue Code of 1954, as amended by this Act, with respect to any directly-written noncancellable accident and health insurance contract (whether under existing or new plans of insurance) for any taxable year if—

"(1) such company—

"(A) was using the net level reserve method to compute at least 99 percent of its statutory reserves on such contracts as of December 31, 1982, and

"(B) received more than half its total direct premiums in 1982 from directly-written noncancellable accident and health insurance,

"(2) after December 31, 1983, and through such taxable year, such company has continuously used the net level reserve method for computing at least 99 percent of its tax and statutory reserves on such contracts, and

"(3) for any such contract for which the company does not use the net level reserve method, such company uses the same method for computing tax reserves as such company uses for computing its statutory reserves."

SEC. 1824. AMENDMENT RELATED TO SECTION 218 OF THE ACT.

Section 218 of the Tax Reform Act of 1984 is hereby repealed.

SEC. 1825. AMENDMENTS RELATED TO SECTION 221 OF THE ACT.

(a) COMPUTATIONAL RULES.—

(1) Paragraph (1) of section 7702(e) (relating to computational rules) is amended—

(A) by striking out "shall be no earlier than" in subparagraph (B) and inserting in lieu thereof "shall be deemed to be no earlier than",

(B) by striking out "and" at the end of subparagraph (B),

(C) by redesignating subparagraph (C) as subparagraph (D) and inserting after subparagraph (B) the following new subparagraph:

"(C) the death benefits shall be deemed to be provided until the maturity date determined by taking into account subparagraph (B), and", and

(D) by striking out "the maturity date described in subparagraph (B)" in subparagraph (D) (as so redesignated) and inserting in lieu thereof "the maturity date determined by taking into account subparagraph (B)".

(2) Subparagraph (C) of section 7702(b)(2) is amended by striking out "subparagraphs (A) and (C)" and inserting in lieu thereof "subparagraphs (A) and (D)".

(3) Section 7702(e)(1) is amended by inserting "(other than subsection (d))" after "section".

(4) Section 7702(e)(2) is amended—

(A) by striking out "and" at the end of subparagraph (A),

(B) by striking out the period at the end of subparagraph (B), and inserting in lieu thereof a comma and "and", and

(C) by adding at the end thereof the following new subparagraph:

"(C) for purposes of the cash value accumulation test, the death benefit increases may be taken into account if the contract—

"(i) has an initial death benefit of $5,000 or less and a maximum death benefit of $25,000 or less,

"(ii) provides for a fixed predetermined annual increase not to exceed 10 percent of the initial death benefit or 8 percent of the death benefit at the end of the preceding year, and

"(iii) was purchased to cover payment of burial expenses or in connection with prearranged funeral expenses.

For purposes of subparagraph (C), the initial death benefit of a contract shall be determined by treating all contracts issued to the same contract owner as 1 contract."

(b) CLARIFICATION OF SECTION 7702(f)(7).—

(1) Paragraph (7) of section 7702(f) (relating to adjustments) is amended to read as follows:

"(7) ADJUSTMENTS.—

"(A) IN GENERAL.—If there is a change in the benefits under (or in other terms of) the contract which was not reflected in any previous determination or adjustment made under this section, there shall be proper adjustments in future determinations made under this section.

"(B) RULE FOR CERTAIN CHANGES DURING FIRST 15 YEARS.—If—

"(i) a change described in subparagraph (A) reduces benefits under the contract,

"(ii) the change occurs during the 15-year period beginning on the issue date of the contract, and

"(iii) a cash distribution is made to the policyholder as a result of such change,

section 72 (other than subsection (e)(5) thereof) shall apply to such cash distribution to the extent it does not exceed the recapture ceiling determined under subparagraph (C) or (D) (whichever applies).

"(C) RECAPTURE CEILING WHERE CHANGE OCCURS DURING FIRST 5 YEARS.—If the change referred to in subparagraph

(B)(ii) occurs during the 5-year period beginning on the issue date of the contract, the recapture ceiling is—

"(i) in the case of a contract to which subsection (a)(1) applies, the excess of—

"(I) the cash surrender value of the contract, immediately before the reduction, over

"(II) the net single premium (determined under subsection (b)), immediately after the reduction, or

"(ii) in the case of a contract to which subsection (a)(2) applies, the greater of—

"(I) the excess of the aggregate premiums paid under the contract, immediately before the reduction, over the guideline premium limitation for the contract (determined under subsection (c)(2), taking into account the adjustment described in subparagraph (A)), or

"(II) the excess of the cash surrender value of the contract, immediately before the reduction, over the cash value corridor of subsection (d) (determined immediately after the reduction).

"(D) RECAPTURE CEILING WHERE CHANGE OCCURS AFTER 5TH YEAR AND BEFORE 16TH YEAR.—If the change referred to in subparagraph (B) occurs after the 5-year period referred to under subparagraph (C), the recapture ceiling is the excess of the cash surrender value of the contract, immediately before the reduction, over the cash value corridor of subsection (d) (determined immediately after the reduction and whether or not subsection (d) applies to the contract).

"(E) TREATMENT OF CERTAIN DISTRIBUTIONS MADE IN ANTICIPATION OF BENEFIT REDUCTIONS.—Under regulations prescribed by the Secretary, subparagraph (B) shall apply also to any distribution made in anticipation of a reduction in benefits under the contract. For purposes of the preceding sentence, appropriate adjustments shall be made in the provisions of subparagraphs (C) and (D); and any distribution which reduces the cash surrender value of a contract and which is made within 2 years before a reduction in benefits under the contract shall be treated as made in anticipation of such reduction."

(2) Subparagraph (A) of section 7702(f)(1) (defining premiums paid) is amended by striking out "less any other amounts received" and inserting in lieu thereof "less any excess premiums with respect to which there is a distribution described in subparagraph (B) or (E) of paragraph (7) and any other amounts received".

(c) CLARIFICATION OF TREATMENT OF CONTRACTS WHICH DO NOT MEET TEST.—Clause (ii) of section 7702(g)(1)(B) (defining income on the contract) is amended to read as follows:

"(ii) the premiums paid (as defined in subsection (f)(1)) under the contract during the taxable year."

(d) TREATMENT OF FLEXIBLE PREMIUM CONTRACTS ISSUED DURING 1984 WHICH MEET NEW REQUIREMENTS.—Subsection (b) of section 221 of the Tax Reform Act of 1984 (relating to 1-year extension of

flexible premium contract provisions) is amended by adding at the end thereof the following new paragraph:

"(3) TRANSITIONAL RULE.—Any flexible premium contract issued during 1984 which meets the requirements of section 7702 of the Internal Revenue Code of 1954 (as added by this section) shall be treated as meeting the requirements of section 101(f) of such Code."

(e) TREATMENT OF CERTAIN CONTRACTS ISSUED BEFORE OCTOBER 1, 1984.—Clause (i) of section 221(d)(2)(C) of the Tax Reform Act of 1984 (relating to certain contracts issued before October 1, 1984) is amended—

(1) by striking out "in clause (i) thereof" in the material preceding subclause (I), and

(2) by striking out "any mortality charges" in subclause (I) and inserting in lieu thereof "any mortality charges and any initial excess interest guarantees".

SEC. 1826. AMENDMENTS RELATED TO SECTION 222 OF THE ACT.

(a) EXCEPTION FOR ANNUITY CONTRACTS WHICH ARE PART OF QUALIFIED PLANS.—Subsection (s) of section 72 (relating to required distributions where holder dies before entire interest is distributed) is amended by adding at the end thereof the following new paragraph:

"(5) EXCEPTION FOR ANNUITY CONTRACTS WHICH ARE PART OF QUALIFIED PLANS.—This subsection shall not apply to any annuity contract—

"(A) which is provided—

"(i) under a plan described in section 401(a) which includes a trust exempt from tax under section 501, or

"(ii) under a plan described in section 403(a),

"(B) which is described in section 403(b), or

"(C) which is an individual retirement annuity or provided under an individual retirement account or annuity."

(b) SPECIAL RULES WHERE HOLDER IS NOT INDIVIDUAL, ETC.—

(1) Subsection (s) of section 72 (relating to required distributions where holder dies before entire interest is distributed) is amended by adding at the end thereof the following new paragraphs:

"(6) SPECIAL RULE WHERE HOLDER IS CORPORATION OR OTHER NON-INDIVIDUAL.—

"(A) IN GENERAL.—For purposes of this subsection, if the holder of the contract is not an individual, the primary annuitant shall be treated as the holder of the contract.

"(B) PRIMARY ANNUITANT.—For purposes of subparagraph (A), the term 'primary annuitant' means the individual, the events in the life of whom are of primary importance in affecting the timing or amount of the payout under the contract.

"(7) TREATMENT OF CHANGES IN PRIMARY ANNUITANT WHERE HOLDER OF CONTRACT IS NOT AN INDIVIDUAL.—For purposes of this subsection, in the case of a holder of an annuity contract which is not an individual, if there is a change in a primary annuity (as defined in paragraph (6)(B)), such change shall be treated as the death of the holder."

(2) Paragraph (1) of section 72(s) is amended by striking out "the holder of such contract" each place it appears and inserting in lieu thereof "any holder of such contract".

(3) Paragraph (4) of section 72(e) (relating to amounts not received as annuities) is amended by adding at the end thereof the following new subparagraph:

"(C) TREATMENT OF TRANSFERS WITHOUT ADEQUATE CONSIDERATION.—

"(i) IN GENERAL.—If an individual who holds an annuity contract transfers it without full and adequate consideration, such individual shall be treated as receiving an amount equal to the excess of—

"(I) the cash surrender value of such contract at the time of transfer, over

"(II) the investment in such contract at such time,

under the contract as an amount not received as an annuity.

"(ii) EXCEPTION FOR CERTAIN TRANSFERS BETWEEN SPOUSES OR FORMER SPOUSES.—Clause (i) shall not apply to any transfer to which section 1041(a) (relating to transfers of property between spouses or incident to divorce) applies.

"(iii) ADJUSTMENT TO INVESTMENT IN CONTRACT OF TRANSFEREE.—If under clause (i) an amount is included in the gross income of the transferor of an annuity contract, the investment in the contract of the transferee in such contract shall be increased by the amount so included."

(4) The amendments made by this subsection shall apply to contracts issued after the date which is 6 months after the date of the enactment of this Act in taxable years ending after such date.

(c) CLARIFICATION OF EXCEPTION FOR DISTRIBUTION AFTER DEATH.—Effective with respect to distributions made after the date 6 months after the date of the enactment of this Act, subparagraph (B) of section 72(q)(2) (relating to 5-percent penalty for premature distributions from annuity contracts) is amended to read as follows:

"(B) made on or after the death of the holder (or, where the holder is not an individual, the death of the primary annuitant (as defined in subsection (s)(6)(B))),".

(d) EXCEPTION FOR ANNUITIES WHICH ARE QUALIFIED FUNDING ASSETS.—Paragraph (2) of section 72(q) (relating to 5-percent penalty for premature distributions from annuity contracts) is amended by striking out "or" at the end of subparagraph (E), by striking out the period at the end of subparagraph (F) and inserting in lieu thereof ", or", and by adding at the end thereof the following new subparagraph:

"(G) under a qualified funding asset (within the meaning of section 130(d), but without regard to whether there is a qualified assignment)."

SEC. 1827. AMENDMENTS RELATED TO SECTION 223 OF THE ACT.

(a) DETERMINATION OF COSTS IN THE CASE OF DISCRIMINATORY PLANS.—

(1) IN GENERAL.—Subparagraph (B) of section 79(d)(1) (relating to nondiscrimination requirements) is amended to read as follows:

"(B) the cost of group-term life insurance on the life of any key employee shall be the greater of—

"(i) such cost determined without regard to subsection (c), or

"(ii) such cost determined with regard to subsection (c)."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to taxable years ending after the date of the enactment of this Act.

(b) CLARIFICATION OF EFFECTIVE DATE.—

(1) Subparagraph (A) of section 223(d)(2) of the Tax Reform Act of 1984 (relating to treatment of former employees in case of existing group-term insurance plans) is amended by striking out the material following clause (ii) and inserting in lieu thereof the following:

"but only with respect to an individual who attained age 55 on or before January 1, 1984, and was employed by such employer (or a predecessor employer) at any time during 1983. Such amendments also shall not apply to any employee who retired from employment on or before January 1, 1984, and who, when he retired, was covered by the plan (or a predecessor plan)."

(2) Subparagraph (C) of section 223(d)(2) of the Tax Reform Act of 1984 is amended by striking out "after December 31, 1986," and by striking out "shall not be taken into account" and inserting in lieu thereof "may, at the employer's election, be disregarded".

(3) COMPARABLE SUCCESSOR PLANS.—Paragraph (2) of section 223(d) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subparagraph:

"(D) COMPARABLE SUCCESSOR PLANS.—For purposes of subparagraph (A), a plan shall not fail to be treated as a comparable successor to a plan described in subparagraph (A)(i) with respect to any employee whose benefits do not increase under the successor plan."

(c) DEFINITION OF KEY EMPLOYEE.—Paragraph (6) of section 79(d) (defining key employee) is amended—

(1) by striking out all that follows "section 416(i)" and inserting in lieu thereof a period, and

(2) by adding at the end thereof the following new sentence: "Such term also includes any retired employee if such employee when he retired or separated from service was a key employee."

(d) SEPARATE TREATMENT OF FORMER EMPLOYEES.—Subsection (d) of section 79 (relating to nondiscrimination requirements) is amended by adding at the end thereof the following new paragraph:

"(8) TREATMENT OF FORMER EMPLOYEES.—To the extent provided in regulations, this subsection shall be applied separately with respect to former employees."

(e) Coordination With Section 83.—Paragraph (5) of section 83(e) is amended by striking out "the cost of".

SEC. 1828. AMENDMENT RELATED TO SECTION 224 OF THE ACT.

Paragraph (1) of section 1035(b) (defining endowment contract) is amended by striking out "subject to tax under subchapter L".

SEC. 1829. WAIVER OF INTEREST ON CERTAIN UNDERPAYMENTS OF TAX.

No interest shall be payable for any period before July 19, 1984, on any underpayment of a tax imposed by the Internal Revenue Code of 1954, to the extent such underpayment was created or increased by any provision of subtitle A of title II of the Tax Reform Act of 1984 (relating to taxation of life insurance companies).

SEC. 1830. SCOPE OF SECTION 255 OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982.

In the case of any taxable year beginning before January 1, 1982, in applying the provisions of section 255(c)(2) of the Tax Equity and Fiscal Responsibility Act of 1982, the Internal Revenue Service shall give full and complete effect to the terms of any modified coinsurance contract. The terms to be given effect within the meaning of this provision shall include, but are not limited to, the effective date and investment income rate as stated in such contract.

CHAPTER 3—AMENDMENTS RELATED TO TITLE III OF THE ACT

SEC. 1831. AMENDMENT RELATED TO SECTION 301 OF THE ACT.

Clause (iv) of section 170(b)(1)(C) (defining capital gain property) is amended by striking out "this subparagraph" and inserting in lieu thereof "this paragraph".

SEC. 1832. AMENDMENT RELATED TO SECTION 303 OF THE ACT.

Paragraph (2) of section 4940(e) (relating to requirements) is amended by striking out subparagraph (B) and the material following such subparagraph and inserting in lieu thereof the following:

> *"(B) such private foundation was not liable for tax under section 4942 with respect to any year in the base period."*

SEC. 1833. AMENDMENT RELATED TO SECTION 305 OF THE ACT.

Section 6214(c) is amended by striking out "section 4962(b)" and inserting in lieu thereof "section 4963(b)".

SEC. 1834. AMENDMENT RELATED TO SECTION 311 OF THE ACT.

Subparagraph (A) of section 311(a)(3) of the Tax Reform Act of 1984 is amended by striking out "a State law" and inserting in lieu thereof "a State law (originally enacted on April 22, 1977)".

CHAPTER 4—AMENDMENTS RELATED TO TITLE IV OF THE ACT

SEC. 1841. AMENDMENT RELATED TO SECTION 411 OF THE ACT.

Section 6654 (relating to failure by individual to pay estimated income tax) is amended by redesignating subsections (j), (k), and (l) as subsections (k), (l), and (m), respectively, and by inserting after subsection (i) the following new subsection:

"(j) Special Rules for Nonresident Aliens.—In the case of a nonresident alien described in section 6072(c):

"(1) Payable in 3 installments.—There shall be 3 required installments for the taxable year.

"(2) Time for payment of installments.—The due dates for required installments under this subsection shall be determined under the following table:

"In the case of the following required installments:	*The due date is:*
1st	*June 15*
2nd	*September 15*
3rd	*January 15 of the following taxable year.*

"(3) Amount of required installments.—

"(A) First required installment.—In the case of the first required installment, subsection (d) shall be applied by substituting '50 percent' for '25 percent' in subsection (d)(1)(A).

"(B) Determination of applicable percentage.—The applicable percentage for purposes of subsection (d)(2) shall be determined under the following table:

"In the case of the following required installments:	*The applicable percentage is:*
1st	*45*
2nd	*67.5*
3rd	*90."*

SEC. 1842. AMENDMENTS RELATED TO SECTION 421 OF THE ACT.

(a) Coordination With Section 1041.—Section 267 (relating to losses, expenses, and interest with respect to transactions between related taxpayers) is amended by adding at the end thereof the following new subsection:

"(g) Coordination With Section 1041.—Subsection (a)(1) shall not apply to any transfer described in section 1041(a) (relating to transfers of property between spouses or incident to divorce)."

(b) Treatment of Transfers in Trust Where Liability Exceeds Basis.—Section 1041 (relating to transfers of property between spouses or incident to divorce) is amended by adding at the end thereof the following new subsection.

"(e) Transfers in Trust Where Liability Exceeds Basis.—Subsection (a) shall not apply to the transfer of property in trust to the extent that—

"(1) the sum of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds

"(2) the total of the adjusted basis of the property transferred. Proper adjustment shall be made under subsection (b) in the basis of the transferee in such property to take into account gain recognized by reason of the preceding sentence."

(c) Treatment of Certain Transfers in Trust.—Subsection (g) of section 453B (relating to transfers between spouses, or incident to divorce) is amended by striking out "section 1041" and inserting in lieu thereof "section 1041 (other than a transfer in trust)".

(d) Clerical Amendment.—Paragraph (17) of section 7701(a) (defining husband and wife as including former husband and wife) is amended by striking out "and 682" and inserting in lieu thereof ", 682, and 2516".

SEC. 1843. AMENDMENTS RELATED TO SECTION 422 OF THE ACT.

(a) Cross Reference.—Section 71 (relating to alimony and separate maintenance payments) is amended by adding at the end thereof the following new subsection:

"(g) Cross References.—

"(1) For deduction of alimony or separate maintenance payments, see section 215.

"(2) For taxable status of income of an estate or trust in the case of divorce, etc., see section 682."

(b) Instrument Not Required to Specify Absence of Liability To Make Payments After Death.—Subparagraph (D) of section 71(b)(1) (defining alimony or separate maintenance payments) is amended by striking out "(and the divorce or separation instrument states that there is no such liability)".

(c) Recomputation Where Excess Front-Loading of Alimony Payments.—

(1) In general.—Subsection (f) of section 71 is amended to read as follows:

"(f) Recomputation Where Excess Front-Loading of Alimony Payments—

"(1) In general.—If there are excess alimony payments—

"(A) the payor spouse shall include the amount of such excess payments in gross income for the payor spouse's taxable year beginning in the 3rd post-separation year, and

"(B) the payee spouse shall be allowed a deduction in computing adjusted gross income for the amount of such excess payments for the payee's taxable year beginning in the 3rd post-separation year.

"(2) Excess alimony payments.—For purposes of this subsection, the term 'excess alimony payments' mean the sum of—

"(A) the excess payments for the 1st post-separation year, and

"(B) the excess payments for the 2nd post-separation year.

"(3) Excess payments for 1st post-separation year.—For purposes of this subsection, the amount of the excess payments for the 1st post-separation year is the excess (if any) of—

"(A) the amount of the alimony or separate maintenance payments paid by the payor spouse during the 1st post-separation year, over

"(B) the sum of—

"(i) the average of—

"(I) the alimony or separate maintenance payments paid by the payor spouse during the 2nd post-separation year, reduced by the excess payments for the 2nd post-separation year, and

"(II) the alimony or separate maintenance payments paid by the payor spouse during the 3rd post-separation year, plus

"(ii) $15,000.

"(4) EXCESS PAYMENTS FOR 2ND POST-SEPARATION YEAR.—For purposes of this subsection, the amount of the excess payments for the 2nd post-separation year is the excess (if any) of—

"(A) the amount of the alimony or separate maintenance payments paid by the payor spouse during the 2nd post-separation year, over

"(B) the sum of—

"(i) the amount of the alimony or separate maintenance payments paid by the payor spouse during the 3rd post-separation year, plus

"(ii) $15,000.

"(5) EXCEPTIONS.—

"(A) WHERE PAYMENT CEASES BY REASON OF DEATH OR REMARRIAGE.—Paragraph (1) shall not apply if—

"(i) either spouse dies before the close of the 3rd post-separation year, or the payee spouse remarries before the close of the 3rd post-separation year, and

"(ii) the alimony or separate maintenance payments cease by reason of such death or remarriage.

"(B) SUPPORT PAYMENTS.—For purposes of this subsection, the term 'alimony or separate maintenance payment' shall not include any payment received under a decree described in subsection (b)(2)(C).

"(C) FLUCTUATING PAYMENTS NOT WITHIN CONTROL OF PAYOR SPOUSE.—For purposes of this subsection, the term 'alimony or separate maintenance payment' shall not include any payment to the extent it is made pursuant to a continuing liability (over a period of not less than 3 years) to pay a fixed portion or portions of the income from a business or property or from compensation for employment or self-employment.

"(6) POST-SEPARATION YEARS.—For purposes of this subsection, the term '1st post-separation years' means the 1st calendar year in which the payor spouse paid to the payee spouse alimony or separate maintenance payments to which this section applies. The 2nd and 3rd post-separation years shall be the 1st and 2nd succeeding calendar years, respectively."

(2) EFFECTIVE DATES.—

"(A) IN GENERAL.—The amendment made by paragraph (1) shall apply with respect to divorce or separation instruments (as defined in section 71(b)(2) of the Internal Revenue Code of 1986 executed after December 31, 1986.

"(B) MODIFICATIONS OF INSTRUMENTS EXECUTED BEFORE JANUARY 1, 1987.—The amendments made by paragraph (1) shall also apply to any divorce or separation instrument (as so defined) executed before January 1, 1987, but modified on or after such date if the modification expressly provides that the amendments made by paragraph (1) shall apply to such modification.

(3) TRANSITIONAL RULE.—In the case of any instrument to which the amendment made by paragraph (1) does not apply, paragraph (2) of section 71(f) of the Internal Revenue Code of 1954 (as in effect on the day before the date of the enactment of

this Act) shall apply only with respect to the first 3 post-separation years.

(d) Clerical Amendment.—Subparagraph (B) of section 71(c)(2) (relating to treatment of certain reductions related to contingency involving child) is amended by striking out "specified in paragraph (1)" and inserting in lieu thereof "specified in subparagraph (A)".

SEC. 1844. AMENDMENTS RELATED TO SECTION 431 OF THE ACT.

(a) Definition of Related Person.—Clause (v) of section 46(c)(8)(D) is amended by striking out "clause (i)" and inserting in lieu thereof "this subparagraph".

(b) Clarification of Recapture.—

(1) Paragraph (1) of section 47(d) (relating to increases in nonqualified nonrecourse financing) is amended—

(A) by striking out "reducing the qualified investment" and inserting in lieu thereof "reducing the credit base (as defined in section 48(c)(8)(C))", and

(B) by adding at the end thereof the following new sentence: "For purposes of determining the amount of credit subject to the early disposition or cessation rules of subsection (a), the net increase in the amount of the nonqualified nonrecourse financing with respect to the property shall be treated as reducing the property's credit base (and correspondingly reducing the qualified investment in the property) in the year in which the property was first placed in service."

(2) Subparagraph (F) of section 47(d)(3) is hereby repealed.

(3) Subparagraph (A) of section 46(c)(9) (relating to subsequent decreases in nonqualified nonrecourse financing with respect to property) is amended by striking out "additional qualified investment in" and inserting in lieu thereof "an increase in the credit base for".

(4) Clause (i) of section 47(d)(3)(E) is amended by inserting before the semicolon at the end thereof the following: "reduced by the sum of the credit recapture amounts with respect to such property for all preceding taxable years".

(5) Clause (i) of section 46(c)(9)(C) is amended by striking out "any increase in a taxpayer's qualified investment" and all that follows down through the period at the end thereof and inserting in lieu thereof the following: "any increase in a taxpayer's credit base for any property by reason of this paragraph shall be taken into account as if it were property placed in service by the taxpayer in the taxable year in which the property referred to in subparagraph (A) was first placed in service."

SEC. 1845. AMENDMENT RELATED TO SECTION 452 OF THE ACT.

Section 456 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subsection:

"(d) Section 452.—The amendment made by section 452 shall apply to products manufactured or produced after October 31, 1984."

SEC. 1846. AMENDMENTS RELATED TO SECTION 473 OF THE ACT.

Subsection (d) of section 39 (relating to transitional rules) is amended—

(1) by striking out "or 44G" in paragraph (1)(A) and inserting in lieu thereof "or 44G (as in effect before the enactment of the Tax Reform Act of 1984)", and

(2) by striking out "as so defined in section 25(b)" in paragraph (2)(B) and inserting in lieu thereof "as defined in section 26(b)".

SEC. 1847. AMENDMENTS RELATED TO SECTION 474 OF THE ACT.

(a) MINIMUM TAX AMENDMENTS.—

(1) Subparagraph (A) of section 55(c)(3) (relating to carryover and carryback of certain credits) is amended by striking out "of such limitation" and inserting in lieu thereof "of such credit allowable".

(2) Effective with respect to taxable years beginning after December 31, 1982, clause (i) of section 55(c)(2)(E) (relating to special rule for applying section 904(c)) is amended to read as follows:

> *"(i) the limitation of section 904(a) shall be deemed to be the amount of foreign tax credit allowable under section 27(a) in computing the regular tax for the taxable year increased by the amount of the limitation determined under subparagraph (C), and".*

(b) CLERICAL AMENDMENTS.—

(1) The clause heading for clause (iii) of section 30(b)(2)(D) is amended by striking out "NEW JOBS OR WIN CREDIT" and inserting in lieu thereof "TARGETED JOBS CREDIT".

(2) Paragraph (1) of section 86(f) is amended by striking out "section 37(c)(3)(A)" and inserting in lieu thereof "section 22(c)(3)(A)".

(3) Subparagraph (C) of section 151(e)(5) is amended by striking out "section 37(e)" and inserting in lieu thereof "section 22(e)".

(4) Clause (i) of section 415(c)(3)(C) is amended by striking out "section 37(e)(3)" and inserting in lieu thereof "section 22(e)(3)".

(5) Paragraph (9) of section 422A(c) is amended by striking out "section 37(e)(3)" and inserting in lieu thereof "section 22(e)(3)".

(6) Paragraph (5) of section 48(l) is amended—

(A) by striking out "section 44C(c)" and inserting in lieu thereof "section 23(c)", and

(B) by striking out "section 44C(c)(4)(A)(viii)" and inserting in lieu thereof "section 23(c)(4)(A)(viii)".

(7) Subparagraph (E) of section 108(b)(2) is amended by striking out "section 33" and inserting in lieu thereof "section 27".

(8) Subsection (b) of section 280C is amended—

(A) by striking out "section 29" each place it appears and inserting in lieu thereof "section 28", and

(B) by striking out "section 29(b)" and inserting in lieu thereof "section 28(b)".

(9) Section 6699 is amended—

(A) by striking out "section 44G" each place it appears in subsections (a) and (c)(2)(B) and inserting in lieu thereof "section 41", and

(B) by striking out “section 44G(c)(1)(B)” in subsection (a)(4) and inserting in lieu thereof “section 41(c)(1)(B)”.

(10) Subsection (a) of section 6411 is amended by striking out “or unused business credit” in the second sentence thereof and inserting in lieu thereof “unused research credit, or unused business credit”.

(11) Subparagraph (A) of section 46(b)(2) is amended by striking out “48(l)(3)(A)(vii)” in the table contained in such subparagraph and inserting in lieu thereof “48(l)(3)(A)(viii)”.

(12) Paragraph (1) of section 163(b) of the Tax Reform Act of 1984 is amended by inserting “(as amended by sections 211, 314, and 474 of this Act)” after “Section 6501”.

(13) Section 6501 is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

“(n) DEFICIENCIES ATTRIBUTABLE TO ELECTION OF CERTAIN CREDITS.—The period for assessing a deficiency attributable to any election under section 40(f) or 51(j) (or any revocation thereof) shall not expire before the date 1 year after the date on which the Secretary is notified of such election (or revocation).”

(14) Subsection (k) of section 6501 is amended by striking out “an investment credit carryback, or a work incentive program carryback, or a new employee credit carryback” and inserting in lieu thereof “or a credit carryback (as defined in section 6511(d)(4)(C))”.

(15) Subsection (h) of section 6511 (relating to limitations on credit or refund) is amended—

(A) by striking out “section 6501(q)(1)(B)” in paragraph (1) and inserting in lieu thereof “section 6501(m)(1)(B)”, and

(B) by striking out “section 6501(q)(2)(B)” in paragraph (2) and inserting in lieu thereof “section 6501(m)(2)(B)”.

(16) Paragraph (1) of section 665(d) is amended by striking out “subpart A of part IV” and inserting in lieu thereof “part IV”.

SEC. 1848. AMENDMENTS RELATED TO SECTION 491 OF THE ACT.

(a) Paragraph (9) of section 46(f) (relating to special rule for additional credit) is hereby repealed.

(b) Subparagraph (A) of section 401(c)(2) (defining earned income) is amended by striking out “sections 404 and 405(c)” and inserting in lieu thereof “section 404”.

(c) Subparagraph (D) of section 404(a)(8) is amended by striking out “the deductions allowed by this section and section 405(c)” and inserting in lieu thereof “the deduction allowed by this section”.

(d) The second sentence of section 2039(e) is amended by striking out “or a bond described in paragraph (3)”.

(e)(1) Section 6704 is amended—

(A) by striking out “section 6047(e)” each place it appears in subsection (a) and inserting in lieu thereof “section 6047(d)”, and

*(B) by striking out “**SECTION 6047(e)**” in the section heading and inserting in lieu thereof “**SECTION 6047(d)**”.*

(2) Subsection (e) of section 6047 is amended by adding at the end thereof the following new paragraph:

“(3) For provisions relating to penalty for failure to comply with the provi-

sions of subsection (d), see section 6704.”

(3) The table of sections for subchapter B of chapter 68 is amended by striking out “section 6047(e)” in the item relating to section 6704 and inserting in lieu thereof “section 6047(d)”.

(f) Subsection (b) of section 4973 (defining excess contributions) is amended—

(1) by striking out “, individual retirement annuities, or bonds” in the material preceding paragraph (1) and inserting in lieu thereof “or individual retirement annuities”,

(2) by striking out subparagraph (A) of paragraph (1) and inserting in lieu thereof the following:

“(A) the amount contributed for the taxable year to the accounts or for the annuities (other than a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), or 408(d)(3)), over”, and

(3) by striking out “or bonds” in paragraph (2)(C) thereof.

CHAPTER 5—AMENDMENTS RELATED TO TITLE V OF THE ACT

SEC. 1851. AMENDMENTS RELATED TO WELFARE BENEFIT PLAN PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 511 OF THE ACT.—

(1) TREATMENT OF PLANS FOR INDEPENDENT CONTRACTORS.—Paragraph (1) of section 419(g) (relating to extension to plans for independent contractors) is amended by striking out “such a plan” and inserting in lieu thereof “such a relationship”.

(2) AMENDMENTS TO SECTION 419A(d).—

(A) COORDINATION WITH SECTION 415.—Paragraph (2) of section 419A(d) (relating to coordination with section 415) is amended by adding at the end thereof the following new sentence: “Subparagraph (B) of section 415(c)(1) shall not apply to any amount treated as an annual addition under the preceding sentence.”

(B) SEPARATE ACCOUNT REQUIREMENTS APPLY ONLY WHERE THERE IS PRE-FUNDING.—Paragraph (1) of section 419A(d) is amended by adding at the end thereof the following new sentence:

“The requirements of this paragraph shall apply to the first taxable year for which a reserve is taken into account under subsection (c)(2) and to all subsequent taxable years.”

(3) CLARIFICATION OF SECTION 419A(e).—

(A) Subsection (e) of section 419A is amended to read as follows:

“(e) SPECIAL LIMITATIONS ON RESERVES FOR MEDICAL BENEFITS OR LIFE INSURANCE BENEFITS PROVIDED TO RETIRED EMPLOYEES.—

“(1) RESERVE MUST BE NONDISCRIMINATORY.—No reserve may be taken into account under subsection (c)(2) for post-retirement medical benefits or life insurance benefits to be provided to covered employees unless the plan meets the requirements of section 505(b) with respect to such benefits (whether or not such requirements apply to such plan). The preceding sentence shall not apply to any plan maintained pursuant to an agreement be-

tween employee representatives and 1 or more employers if the Secretary finds that such agreement is a collective bargaining agreement and that post-retirement medical benefits or life insurance benefits were the subject of good faith bargaining between such employee representatives and such employer or employers.

"(2) LIMITATION ON AMOUNT OF LIFE INSURANCE BENEFITS.—Life insurance benefits shall not be taken into account under subsection (c)(2) to the extent the aggregate amount of such benefits to be provided with respect to the employee exceeds $50,000."

(B) Subsection (e) of section 419A of the Internal Revenue Code of 1954 (as amended by subparagraph (A)) shall not apply to any group-term life insurance to the extent that the amendments made by section 223(a) of the Tax Reform Act of 1984 do not apply to such insurance by reason of paragraph (2) of section 223(d) of such Act.

(4) TREATMENT OF COLLECTIVELY BARGAINED PLANS.—Paragraph (5) of section 419A(f) (relating to higher limit in case of collectively bargained plans) is amended by striking out "welfare benefit fund established under" and inserting in lieu thereof "welfare benefit fund maintained pursuant to".

(5) CLARIFICATION OF ACTUARIAL CERTIFICATION REQUIREMENT.—Subparagraph (A) of section 419A(c)(5) (relating to special limitation where no actuarial certification) is amended by striking out "under paragraph (1)" and inserting in lieu thereof "under this subsection".

(6) AGGREGATION RULES.—

(A) Paragraph (1) of section 419A(h) (relating to aggregation rules) is amended to read as follows:

"(1) AGGREGATION OF FUNDS.—

"(A) MANDATORY AGGREGATION.—For purposes of subsections (c)(4), (d)(2), and (e)(2), all welfare benefit funds of an employer shall be treated as 1 fund.

"(B) PERMISSIVE AGGREGATION FOR PURPOSES NOT SPECIFIED IN SUBPARAGRAPH (A).—For purposes of this section (other than the provisions specified in subparagraph (A)), at the election of the employer, 2 or more welfare benefit funds of such employer may (to the extent not inconsistent with the purposes of this subpart and section 512) be treated as 1 fund."

(B) Subsection (b) of section 419A is amended by striking out "this subpart" and inserting in lieu thereof "this subpart and section 512".

(7) CLARIFICATION OF ADJUSTMENTS FOR EXISTING RESERVES.—Paragraph (7) of section 419A(f) (relating to adjustments for existing excess reserves) is amended by striking out subparagraph (C) and inserting in lieu thereof the following new subparagraphs:

"(C) EXISTING EXCESS RESERVE.—For purposes of computing the increase under subparagraph (A) for any taxable year, the term 'existing excess reserve' means the excess (if any) of—

"(i) the amount of assets set aside at the close of the first taxable year ending after July 18, 1984, for purposes described in subsection (a), over

"(ii) the account limit determined under this section (without regard to this paragraph) for the taxable year for which such increase is being computed.

"(D) FUNDS TO WHICH PARAGRAPH APPLIES.—This paragraph shall apply only to a welfare benefit fund which, as of July 18, 1984, had assets set aside for purposes described in subsection (a)."

(8)(A) CLARIFICATION OF FUND.—Subsection (e) of section 419 (defining welfare benefit funds) is amended by adding at the end thereof the following new paragraph:

"(4) TREATMENT OF AMOUNTS HELD PURSUANT TO CERTAIN INSURANCE CONTRACTS.—

"(A) IN GENERAL.—Notwithstanding paragraph (3)(C), the term 'fund' shall not include amounts held by an insurance company pursuant to an insurance contract if—

"(i) such contract is a life insurance contract described in section 264(a)(1), or

"(ii) such contract is a qualified nonguaranteed contract.

"(B) QUALIFIED NONGUARANTEED CONTRACT.—

"(i) IN GENERAL.—For purposes of this paragraph, the term 'qualified nonguaranteed contract' means any insurance contract (including a reasonable premium stabilization reserve held thereunder) if—

"(I) there is no guarantee of a renewal of such contract, and

"(II) other than insurance protection, the only payments to which the employer or employees are entitled are experience rated refunds or policy dividends which are not guaranteed and which are determined by factors other than the amount of welfare benefits paid to (or on behalf of) the employees of the employer or their beneficiaries.

"(ii) LIMITATION.—In the case of any qualified nonguaranteed contract, subparagraph (A) shall not apply unless the amount of any experience rated refund or policy dividend payable to an employer with respect to a policy year is treated by the employer as received or accrued in the taxable year in which the policy year ends."

(B) EFFECTIVE DATE OF REGULATIONS.—Except in the case of a reserve for post-retirement medical or life insurance benefits and any other arrangement between an insurance company and an employer under which the employer has a contractual right to a refund or dividend based solely on the experience of such employer, any account held for an employer by any person and defined as a fund in regulations issued pursuant to section 419(e)(3)(C) of the Internal Revenue Code of 1954 shall be considered a "fund" no earlier than 6 months following the date such regulations are published in final form.

(9) CLARIFICATION OF TAXES PAID BY EMPLOYER ON INCOME OF CERTAIN WELFARE BENEFIT FUNDS.—Subsection (g) of section 419A (relating to employer taxed on income of welfare benefit funds in certain cases) is amended by adding at the end thereof the following new paragraph:

"(3) COORDINATION WITH SECTION 419.—If any amount is included in the gross income of an employer for any taxable year under paragraph (1) with respect to any welfare benefit fund—

"(A) the amount of the tax imposed by this chapter which is attributable to the amount so included shall be treated as a contribution paid to such welfare benefit fund on the last day of such taxable year, and

"(B) the tax so attributable shall be treated as imposed on the fund for purposes of section 419(c)(4)(A)."

(10) AMENDMENTS TO TAX ON UNRELATED BUSINESS INCOME.—

(A) Clause (i) of section 512(a)(3)(E) is amended by striking out "determined under section 419A(c)" and inserting in lieu thereof "determined under section 419A (without regard to subsection (f)(6) thereof)".

(B) Subparagraph (E) of section 512(a)(3) is amended by striking out clause (ii) and by redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively.

(C) Clause (ii) of section 512(a)(3)(E) (as redesignated by subparagraph (B)) is amended—

(i) by striking out "a existing reserve" in subclause (I) and inserting in lieu thereof "an existing reserve", and

(ii) by striking out subclause (II) and inserting in lieu thereof the following:

"(II) For purposes of subclause (II), the term 'reserve for post-retirement medical or life insurance benefits' means the greater of the amount of assets set aside for purposes of post-retirement medical or life insurance benefits to be provided to covered employees as of the close of the last plan year ending before the date of the enactment of the Tax Reform Act of 1984 or on July 18, 1984,".

(D) Clause (iii) of section 512(a)(3)(E) (as redesignated by subparagraph (B)) is amended by striking out "paragraph shall not" and inserting in lieu thereof "subparagraph shall not".

(11) AMENDMENTS RELATED TO TAX ON CERTAIN FUNDED WELFARE BENEFIT PLANS.—Subsection (b) of section 4976 (defining disqualified benefit) is amended to read as follows:

"(b) DISQUALIFIED BENEFIT.—For purposes of subsection (a)—

"(1) IN GENERAL.—The term 'disqualified benefit' means—

"(A) any post-retirement medical benefit or life insurance benefit provided with respect to a key employee if a separate account is required to be established for such employee under section 419A(d) and such payment is not from such account,

"(B) any post-retirement medical benefit or life insurance benefit provided with respect to an individual in whose favor discrimination is prohibited unless the plan meets the requirements of section 505(b) with respect to such bene-

fit (whether or not such requirements apply to such plan), and

"(C) any portion of a welfare benefit fund reverting to the benefit of the employer.

"(2) EXCEPTION FOR COLLECTIVE BARGAINING PLANS.—Paragraph (1)(B) shall not apply to any plan maintained pursuant to an agreement between employee representatives and 1 or more employers if the Secretary finds that such agreement is a collective bargaining agreement and that the benefits referred to in paragraph (1)(B) were the subject of good faith bargaining between such employee representatives and such employer or employers.

"(3) EXCEPTION FOR NONDEDUCTIBLE CONTRIBUTIONS.—Paragraph (1)(C) shall not apply to any amount attributable to a contribution to the fund which is not allowable as a deduction under section 419 for the taxable year or any prior taxable year (and such contribution shall not be included in any carryover under section 419(d)).

"(4) EXCEPTION FOR CERTAIN AMOUNTS CHARGED AGAINST EXISTING RESERVE.—Subparagraphs (A) and (B) of paragraph (1) shall not apply to post-retirement benefits charged against an existing reserve for post-retirement medical or life insurance benefits (as defined in section 512(a)(3)(E)) or charged against the income on such reserve."

(12) CLARIFICATION OF EFFECTIVE DATE.—Subsection (e) of section 511 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraphs:

"(6) AMENDMENTS RELATED TO TAX ON UNRELATED BUSINESS INCOME.—The amendments made by subsection (b) shall apply with respect to taxable years ending after December 31, 1985. For purposes of section 15 of the Internal Revenue Code of 1954, such amendments shall be treated as a change in the rate of a tax imposed by chapter 1 of such Code.

"(7) AMENDMENTS RELATED TO EXCISE TAXES ON CERTAIN WELFARE BENEFIT PLANS.—The amendments made by subsection (c) shall apply to benefits provided after December 31, 1985."

(13) Section 419A(f)(5) is amended to read as follows:

"(5) SPECIAL RULE FOR COLLECTIVE BARGAINED AND EMPLOYEE PAY-ALL PLANS.—No accounts limits shall apply in the case of any qualified asset account under a separate welfare benefit fund—

"(A) under a collective bargaining agreement, or

"(B) an employee pay-all plan under section 501(c)(9) if—

"(i) such plan has at least 50 employees (determined without regard to subsection (h)(1)), and

"(ii) no employee is entitled to a refund with respect to amounts in the fund, other than a refund based on the experience of the entire fund."

(14) CLERICAL AMENDMENT.—Paragraph (2) of section 511(e) of the Tax Reform Act of 1984 is amended by striking out "and section 514".

(b) AMENDMENTS RELATED TO SECTION 512 OF THE ACT.—

(1) TRANSITIONAL RULE FOR CERTAIN TAXPAYERS WITH FULLY VESTED VACATION PAY PLANS.—

(A) In general.—In the case of any taxpayer—

(i) who maintained a fully vested vacation pay plan where payments are expected to be paid (or are in fact paid) within 1 year after the accrual of the vacation pay, and

(ii) who makes an election under section 463 of the Internal Revenue Code of 1954 for such taxpayer's 1st taxable year ending after the date of the enactment of the Tax Reform Act of 1984,

in lieu of establishing a suspense account under such section 463, such election shall be treated as a change in the taxpayer's method of accounting and the adjustments required as a result of such change shall be taken into account under section 481 of such Code.

(B) Extension of time for making election.—In the case of any taxpayer who meets the requirements of subparagraph (A)(i), the time for making an election under section 463 of such Code for such taxpayer's 1st taxable year ending after the date of the enactment of the Tax Reform Act of 1984 shall not expire before the date 6 months after the date of the enactment of this Act.

(2) Clerical amendments.—

(A) Clause (ii) of section 404(b)(2)(B) (relating to exceptions for certain benefits) is amended by striking out "to any benefit" and inserting in lieu thereof "any benefit".

(B) Subsection (b) of section 404 is amended—

(i) by striking out "Unfunded" in the subsection heading and inserting in lieu thereof "Certain", and

(ii) by striking out "unfunded" in the heading of paragraph (2) and inserting in lieu thereof "certain".

(C)(i) Section 404(a) is amended by striking out "section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income); but, if they satisfy the conditions of either of such sections," and inserting in lieu thereof "this chapter; but, if they would otherwise be deductible,".

(ii) Subsection (d) of section 404 is amended by striking out "under section 162 or 212" each place it appears and inserting in lieu thereof "under this chapter".

(iii) Subsection (a) of section 404A is amended—

(I) by striking out "under section 162, 212, or 404" and inserting in lieu thereof "under this chapter", and

(II) by striking out "they satisfy the conditions of section 162" and inserting in lieu thereof "they would otherwise be deductible".

(iv) Subsection (a) of section 419 is amended—

(I) by striking out "under section 162 or 212" and inserting in lieu thereof "under this subchapter", and

(II) by striking out "they satisfy the requirements of either of such sections" and inserting in lieu thereof "they would otherwise be deductible".

(c) Amendments Related to Section 513 of the Act.—

(1) Paragraph (1) of section 505(a) (relating to certain requirements must be met in case of organizations described in para-

graph (9) or (20) of section 501(c)) is amended by striking out "of an employer".

(2) Paragraph (1) of section 505(b) (relating to nondiscrimination requirements) is amended by striking out "as provided in paragraph (2)" and inserting in lieu thereof "as otherwise provided in this subsection".

(3) Subparagraph (B) of section 505(b)(1) is amended by striking out "highly compensated employees" and inserting in lieu thereof "highly compensated individuals".

(4) Paragraph (2) of section 505(a) (relating to exception for collective bargaining agreements) is amended to read as follows:

"(2) EXCEPTION FOR COLLECTIVE BARGAINING AGREEMENTS.—Paragraph (1) shall not apply to any organization which is part of a plan maintained pursuant to an agreement between employee representatives and 1 or more employers if the Secretary finds that such agreement is a collective bargaining agreement and that such plan was the subject of good faith bargaining between such employee representatives and such employer or employers."

SEC. 1852. AMENDMENTS RELATED TO PENSION PLAN PROVISIONS.

(a) AMENDMENTS RELATED TO SECTION 521 OF THE ACT.—

(1) CLARIFICATION THAT DISTRIBUTION FROM INDIVIDUAL RETIREMENT ACCOUNTS OR ANNUITIES MUST BEGIN AT 70½.—

(A) Paragraph (6) of section 408(a) (defining individual retirement account) is amended by striking out "(relating to required distributions)" and inserting in lieu thereof "(without regard to subparagraph (C)(ii) thereof) and the incidental death benefit requirements of section 401(a)".

(B) Paragraph (3) of section 408(b) (defining individual retirement annuity) is amended by striking out "(relating to required distributions)" and inserting in lieu thereof "(without regard to subparagraph (C)(ii) thereof) and the incidental death benefit requirements of section 401(a)".

(2) EXEMPTION OF PRE-1985 ACCUMULATIONS FROM PENALTY ON PREMATURE DISTRIBUTIONS.—

(A) Subparagraph (A) of section 72(m)(5) (relating to penalties applicable to certain amounts received by 5-percent owners) is amended to read as follows:

"(A) This subparagraph shall apply—

"(i) to amounts which—

"(I) are received from a qualified trust described in section 401(a) or under a plan described in section 403(a), and

"(II) are received by a 5-percent owner before such owner attains the age of 59½ years, for any reason other than such owner becoming disabled (within the meaning of paragraph (7) of this section), and

"(ii) to amounts which are received from a qualified trust described in section 401(a) or under a plan described in section 403(a) at any time by a 5-percent owner, or by the successor of such owner, but only to the extent that such amounts are determined (under

regulations prescribed by the Secretary) to exceed the benefits provided for such individual under the plan formula.

Clause (i) shall not apply to any amount received by an individual in his capacity as a policyholder of an annuity, endowment, or life insurance contract which is in the nature of a dividend or similar distribution and clause (i) shall not apply to amounts attributable to benefits accrued before January 1, 1985."

(B) Subparagraph (C) of section 72(m)(5) is amended to read as follows:

"(C) For purposes of this paragraph, the term '5-percent owner' means any individual who, at any time during the 5 plan years preceding the plan year ending in the taxable year in which the amount is received, is a 5-percent owner (as defined in section 416(i)(1)(B))."

(C) Paragraph (5) of section 72(m) is amended by striking out "OWNER-EMPLOYEES" in the paragraph heading and inserting in lieu thereof "5-PERCENT OWNERS".

(3) EXTENSION OF DISTRIBUTION REQUIREMENTS TO SECTION 403(b) ANNUITIES.—

(A) Subsection (b) of section 403 (relating to taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school) is amended by adding at the end thereof the following new paragraph:

"(10) DISTRIBUTION REQUIREMENTS.—Under regulations prescribed by the Secretary, this subsection shall not apply to any annuity contract (or to any custodial account described in paragraph (7) or retirement income account described in paragraph (9)) unless requirements similar to the requirements of section 401(a)(9) are met (and requirements similar to the incidental death benefit requirements of section 401(a) are met) with respect to such annuity contract (or custodial account or retirement income account)."

(B) Paragraph (7) of section 403(b) is amended by striking out subparagraph (D).

(C) The amendments made by this paragraph shall apply to benefits accruing after December 31, 1986, in taxable years ending after such date.

(4) CLARIFICATION OF REQUIRED BEGINNING DATE.—

(A) Subparagraph (C) of section 401(a)(9) (defining required beginning date) is amended by striking out the last sentence and inserting in lieu thereof the following:

"Clause (ii) shall not apply in the case of an employee who is a 5-percent owner (as defined in section 416(i)(1)(B)) at any time during the 5-plan-year period ending in the calendar year in which the employee attains age 70½. If the employee becomes a 5-percent owner during any subsequent plan year, the required beginning date shall be April 1 of the calendar year following the calendar year in which such subsequent plan year ends."

(B) Subsection (d) of section 409 (relating to employer securities must stay in the plan) is amended by adding at the end thereof the following new sentence:

"This subsection shall not apply to any distribution required under section 401(a)(9)."

(5) REQUIRED DISTRIBUTIONS NOT ELIGIBLE FOR ROLLOVER TREATMENT.—

(A) Paragraph (5) of section 402(a) (relating to rollover amounts) is amended by adding at the end thereof the following new subparagraph:

"(G) REQUIRED DISTRIBUTIONS NOT ELIGIBLE FOR ROLLOVER TREATMENT.—Subparagraph (A) shall not apply to any distribution to the extent such distribution is required under section 401(a)(9)."

(B)(i) Subparagraph (B) of section 403(a)(4) is amended by striking out "through (F)" and inserting in lieu thereof "through (G)".

(ii) Paragraph (8) of section 403(b) is amended by adding at the end thereof the following new subparagraph:

"(D) REQUIRED DISTRIBUTIONS NOT ELIGIBLE FOR ROLLOVER TREATMENT.—Subparagraph (A) shall not apply to any distribution to the extent such distribution is required under paragraph (10)."

(C) Paragraph (3) of section 408(d) (relating to rollover contributions) is amended by adding at the end thereof the following new subparagraph:

"(E) DENIAL OF ROLLOVER TREATMENT FOR REQUIRED DISTRIBUTIONS.—This subparagraph shall not apply to any amount to the extent such amount is required to be distributed under subsection (a)(6) or (b)(3)."

(6) TREATMENT OF DISTRIBUTIONS REQUIRED UNDER INCIDENTAL DEATH BENEFIT RULES.—Paragraph (9) of section 401(a) (relating to required distributions) is amended by adding at the end thereof the following new subparagraph:

"(G) TREATMENT OF INCIDENTAL DEATH BENEFIT DISTRIBUTIONS.—For purposes of this title, any distribution required under the incidental death benefit requirements of this subsection shall be treated as a distribution required under this paragraph."

(7) CLERICAL AMENDMENTS.—

(A) Paragraph (1) of section 408(c) is amended by striking out "paragraphs (1) through (7)" and inserting in lieu thereof "paragraphs (1) through (6)".

(B) Subsection (a) of section 4974 (relating to excise tax on certain accumulations in individual retirement accounts or annuities) is amended by striking out "section 408(a) (6) or (7), or 408(b) (3) or (4)" and inserting in lieu thereof "section 408(a)(6) or 408(b)(3)".

(C) Subsection (b) of section 4974 is amended by striking out "section 408(a) (6) or (7) or 408(b) (3) or (4)" and inserting in lieu thereof "section 408(a)(6) or 408(b)(3)".

(b) AMENDMENTS RELATED TO SECTION 522 OF THE ACT.—

(1) Clause (v) of section 402(a)(5)(E) (defining partial distribution) is amended by striking out "of any portion of" and inserting in lieu thereof "of all or any portion of".

(2) Clause (i) of section 402(a)(5)(D) (relating to special rules for partial distributions) is amended by adding at the end thereof the following new sentence:

> *"For purposes of subclause (I), the balance to the credit of the employee shall not include any accumulated deductible employee contributions (within the meaning of section 72(o)(5))."*

(3)(A) Section 402 is amended by adding at the end thereof the following new subsection:

"(g) Treatment of Self-Employed Individuals.—For purposes of this section, except as otherwise provided in subparagraph (A) of subsection (e)(4), the term 'employee' includes a self-employed individual (as defined in section 401(c)(1)(B)) and the employer of such individual shall be the person treated as his employer under section 401(c)(4)."

(B) Paragraph (4) of section 402(e) is amended by striking out subparagraph (F).

(4) Paragraph (7) of section 402(a) (relating to rollover where spouse received distributions after death of employee) is amended by striking out "the spouse were the employee" and inserting in lieu thereof "the spouse were the employee; except that a trust or plan described in subclause (III) or (IV) of paragraph (5)(E)(iv) shall not be treated as an eligible retirement plan with respect to such distribution".

(5) Clause (ii) of section 402(a)(5)(D) is amended by striking out "a plan described in subclause (IV) or (V)" and inserting in lieu thereof "a trust or plan described in subclause (III) or (IV)".

(6) Clause (i) of section 402(a)(5)(F) is amended by striking out "a transfer described in subparagraph (A)" and inserting in lieu thereof "a transfer resulting in any portion of a distribution being excluded from gross income under subparagraph (A)".

(7) Clause (v) of section 402(a)(6)(D) is amended by striking out "(7)(B)" and inserting in lieu thereof "(7)".

(8) Paragraph (20) of section 401(a) is amended by striking out "qualifying rollover distribution (determined as if section 402(a)(5)(D)(i) did not contain subclause (II) thereof) described in section 402(a)(5)(A)(i) or 403(a)(4)(A)(i)" and inserting in lieu thereof "qualified total distribution described in section 402(a)(5)(E)(i)(I)".

(9) Subsection (e) of section 522 of the Tax Reform Act of 1984 is amended by striking out "the date of the amendment" and inserting in lieu thereof "the date of the enactment".

(10) Subparagraph (C) of section 403(b)(8) is amended by striking out "(F)(i)" and inserting in lieu thereof "and (F)(i)".

(c) Amendments Related to Section 523 of the Act.—

(1) Subparagraph (B) of section 72(e)(7) (relating to plans substantially all the contributions of which are employee contributions) is amended—

(A) by striking out "any trust or contract" and inserting in lieu thereof "any plan or contract",

(B) by striking out "85 percent of" and inserting in lieu thereof "85 percent or more of", and

(C) by adding at the end thereof the following new sentence:

"For purposes of clause (ii), deductible employee contributions (as defined in subsection (o)(5)(A)) shall not be taken into account."

(2) Subparagraph (E) of section 72(q)(2) (relating to 5-percent penalty for premature distributions from annuity contracts) is amended by striking out "subsection (e)(5)(D)" and inserting in lieu thereof "subsection (e)(5)(D) (determined without regard to subsection (e)(7))".

(3) Subsection (f) of section 72 is amended—

(A) by striking out "subsection (d)(1)" and inserting in lieu thereof "subsections (d)(1) and (e)(7)", and

(B) by striking out "subsection (e)(1)(B)" and inserting in lieu thereof "subsection (e)(6)".

(4) Paragraph (2) of section 72(m) is amended—

(A) by striking out "3 years)" in subparagraph (B) and inserting in lieu thereof "3 years) and subsection (e)(7) (relating to plans where substantially all contributions are employee contributions)", and

(B) by striking out "subsection (e)(1)(B)" in subparagraph (C) and inserting in lieu thereof "subsection (e)(6)".

(5) Subsection (b) of section 402 is amended by striking out "section 72(e)(1)" and inserting in lieu thereof "section 72(e)(5)".

(d) Amendments Related to Section 524 of the Act.—

(1) Subparagraph (A) of section 416(i)(1) (defining key employee) is amended by adding at the end thereof the following new sentence: "Such term shall not include any officer or employee of an entity referred to in section 414(d) (relating to governmental plans)."

(2) Subparagraph (E) of section 416(g)(4) (relating to benefits not taken into account if employee not employed for last 5 years) is amended to read as follows:

"(E) Benefits not taken into account if employee not employed for last 5 years.—If any individual has not performed services for the employer maintaining the plan at any time during the 5-year period ending on the determination date, any accrued benefit for such individual (and the account of such individual) shall not be taken into account."

(e) Amendments Related to Section 525 of the Act.—

(1)(A) Subsection (c) of section 2039 (relating to exception of certain annuity interests created by community property laws) is hereby repealed.

(B) The amendment made by subparagraph (A) shall apply to estates of decedents dying after the date of the enactment of this Act.

(2)(A) Section 2517 (relating to certain annuities under qualified plans) is hereby repealed.

(B) The table of sections for subchapter B of chapter 12 is amended by striking out the item relating to section 2517.

(C) Subsection (e) of section 406 is amended by striking out paragraph (5).

(D) Subsection (e) of section 407 is amended by striking out paragraph (5).

(E) The amendments made by this paragraph shall apply to transfers after the date of the enactment of this Act.

(3) Section 525(b) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraph:

"(4) Irrevocable election.—For purposes of paragraph (2) and section 245(c) of the Tax Equity and Fiscal Responsibility Act of 1982, an individual who—

> *"(A) separated from service before January 1, 1985, with respect to paragraph (2), or January 1, 1983, with respect to section 245(c) of the Tax Equity and Fiscal Responsibility Act of 1982, and*
>
> *"(B) meets the requirements of such paragraph or such section other than the requirement that there be an irrevocable election, and that the individual be in pay status,*

shall be treated as having made an irrevocable election and as being in pay status within the time prescribed with respect to a form of benefit if such individual does not change such form of benefit before death."

(f) Amendment Related to Section 526 of the Act.—Paragraph (2) of section 526(d) of the Tax Reform Act of 1984 is amended by striking out "paragraph (6)" and inserting in lieu thereof "paragraph (7)".

(g) Amendments Related to Section 527 of the Act.—

(1) Paragraph (3) of section 401(k) (relating to application of participation and discrimination standards) is amended by adding at the end thereof the following new subparagraph:

> *"(C) A cash or deferred arrangement shall be treated as meeting the requirements of subsection (a)(4) with respect to contributions if the requirements of subparagraph (A)(ii) are met."*

(2) Subparagraph (A) of section 401(k)(3) is amended by striking out the last sentence and inserting in lieu thereof the following: "If an employee is a participant under 2 or more cash or deferred arrangements of the employer, for purposes of determining the deferral percentage with respect to such employee, all such cash or deferred arrangements shall be treated as 1 cash or deferred arrangement."

(3) Subparagraph (C) of section 401(k)(2) is amended by striking out "are nonforfeitable" and inserting in lieu thereof "is nonforfeitable".

(h) Amendments Related to Section 528 of the Act.—

(1) Subsection (h) of section 401 (relating to medical, etc., benefits for retired employees and their spouses and dependents) is amended—

> *(A) by striking out "5-percent owner" each place it appears in paragraph (6) and inserting in lieu thereof "key employee", and*
>
> *(B) by striking out the last sentence and inserting in lieu thereof the following:*

"For purposes of paragraph (6), the term 'key employee' means any employee, who at any time during the plan year or any preceding

plan year during which contributions were made on behalf of such employee, is or was a key employee as defined in section 416(i)."

(2) Paragraph (1) of section 416(l) (relating to treatment of certain medical benefits) is amended by adding at the end thereof the following new sentence: "Subparagraph (B) of subsection (c)(1) shall not apply to any amount treated as an annual addition under the preceding sentence."

(3) Subsection (l) of section 415 is amended by striking out "a defined benefit plan" each place it appears and inserting in lieu thereof "a pension or annuity plan".

(i) AMENDMENT RELATED TO SECTION 4402 OF ERISA.—Section 4402 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1461) is amended by adding at the end thereof the following new subsection:

"(h)(1) In the case of an employer who entered into a collective bargaining agreement—

"(A) which was effective on January 12, 1979, and which remained in effect through May 15, 1982, and

"(B) under which contributions to a multiemployer plan were to cease on January 12, 1982,

any withdrawal liability incurred by the employer pursuant to part 1 of subtitle E as a result of the complete or partial withdrawal of the employer from the multiemployer plan before January 12, 1982, shall be void.

"(2) In any case in which—

"(A) an employer engaged in the grocery wholesaling business—

"(i) had ceased all covered operations under a multiemployer plan before June 30, 1981, and had relocated its operations to a new facility in another State, and

"(ii) had notified a local union representative on May 14, 1980, that the employer had tentatively decided to discontinue operations and relocate to a new facility in another State, and

"(B) all State and local approvals with respect to construction of an commencement of operations at the new facility had been obtained, a contract for construction had been entered into, and construction of the new facility had begun before September 26, 1980,

any withdrawal liability incurred by the employer pursuant to part 1 of subtitle E as a result of the complete or partial withdrawal of the employer from the multiemployer plan before June 30, 1981, shall be void.".

SEC. 1853. AMENDMENTS RELATED TO FRINGE BENEFIT PROVISIONS.

(a) AMENDMENTS TO SECTION 132.—

(1) Clause (ii) of section 132(f)(2)(B) (defining dependent children) is amended by striking out "are deceased" and inserting in lieu thereof "are deceased and who has not attained age 25".

(2) Subparagraph (A) of section 132(c)(3) (defining employee discount) is amended by striking out "are provided to the employee by the employer" and inserting in lieu thereof "are provided by the employer to an employee for use by such employee".

(3) Subsection (i) of section 132 (relating to customers not to include employees) is amended by striking out "subsection (c)(2)(B)" and inserting in lieu thereof "subsection (c)(2)".

(b) AMENDMENTS TO SECTION 125.—

(1) CLARIFICATION OF BENEFITS WHICH MAY BE PROVIDED UNDER CAFETERIA PLANS.—

(A) Subsections (c) and (d)(1)(B) of section 125 are each amended by striking out "statutory nontaxable benefits" each place it appears and inserting in lieu thereof "qualified benefits".

(B) Subsection (f) of section 125 is amended to read as follows:

"(f) QUALIFIED BENEFITS DEFINED.—For purposes of this section, the term 'qualified benefit' means any benefit which, with the application of subsection (a), is not includible in the gross income of the employee by reason of an express provision of this chapter (other than section 117, 124, 127, or 132). Such term includes any group term life insurance which is includible in gross income only because it exceeds the dollar limitation of section 79 and such term includes any other benefit permitted under regulations."

(2) TRANSITIONAL RULE.—Paragraph (5) of section 531(b) of the Tax Reform Act of 1984 (relating to exception for certain cafeteria plans and benefits) is amended by adding at the end thereof the following new subparagraph:

"(D) COLLECTIVE BARGAINING AGREEMENTS.—In the case of any cafeteria plan in existence on February 10, 1984, and maintained pursuant to 1 or more collective bargaining agreements between employee representatives and 1 or more employers, the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof agreed to after July 18, 1984) shall be substituted for 'January 1, 1985' in subparagraph (A) and for 'July 1, 1985' in subparagraph (B). For purposes of the preceding sentence, any plan amendment made pursuant to a collective bargaining agreement relating to the plan which amends the plan solely to conform to any requirement added by this section (or any requirement in the regulations under section 125 of the Internal Revenue Code of 1954 proposed on May 6, 1984) shall not be treated as a termination of such collective bargaining agreement."

(3) SPECIAL RULE WHERE CONTRIBUTIONS OR REIMBURSEMENTS SUSPENDED.—Paragraph (5) of section 531(b) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subparagraph:

"(E) SPECIAL RULE WHERE CONTRIBUTIONS OR REIMBURSEMENTS SUSPENDED.—For purposes of subparagraphs (A) and (B), a plan shall not be treated as not continuing to fail to satisfy the rules referred to in such subparagraphs with respect to any benefit provided in the form of a flexible spending arrangement merely because contributions or reimbursements (or both) with respect to such plan were suspended before January 1, 1985."

(c) AMENDMENTS TO SECTION 4977.—

(1) Paragraph (2) of section 4977(c) is amended to read as follows:

"(2) at all times on or after January 1, 1984, and before the close of the calendar year involved, substantially all of the employees of the employer were entitled to employee discounts on goods or services provided by the employer in 1 line of business,".

(2) Section 4977 (relating to tax on certain fringe benefits provided by an employer) is amended by adding at the end thereof the following new subsection:

"(f) Section To Apply Only to Employment Within the United States.—Except as otherwise provided in regulations, this section shall apply only with respect to employment within the United States."

(3) For purposes of determining whether the requirements of section 4977(c) of the Internal Revenue Code of 1954 are met in the case of an agricultural cooperative incorporated in 1964, there shall not be taken into account employees of a member of the same controlled group as such cooperative which became a member during July 1980.

(d) Treatment of Telephone Concession Service for Certain Retirees.—Section 559 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following subsection:

"(e) Telephone Service for Pre-Divestiture Retirees.—In the case of an employee who, by reason of retirement or disability, separated before January 1, 1984, from the service of an entity subject to the modified final judgment—

"(1) all entities subject to the modified final judgment shall be treated as a single employer in the same line of business for purposes of determining whether telephone service provided to the employee is a no-additional-cost service as defined in section 132 of the Internal Revenue Code of 1954; and

"(2) payment by an entity subject to the modified final judgment of all or part of the cost of local telephone service provided to the employee by a person other than an entity subject to the modified final judgment (including rebate of the amount paid by the employee for the service and payment to the person providing the service) shall be treated as telephone service provided to the employee by such single employer for purposes of determining whether the telephone service is a no-additional-cost service as defined in section 132 of the Internal Revenue Code of 1954.

For purposes of this subsection, the term 'employee' has the meaning given to such term by section 132(f) of the Internal Revenue Code of 1954."

(e) Treatment of Certain Leased Operations of Department Stores.—For purposes of section 132(h)(2)(B) of the Internal Revenue Code of 1954, a leased section of a department store which, in connection with the offering of beautician services, customarily makes sales of beauty aids in the ordinary course of business shall be treated as engaged in over-the-counter sales of property.

(f) Transitional Rules for Treatment of Certain Reductions in Tuition.—

(1) A tuition reduction plan shall be treated as meeting the requirements of section 117(d)(3) of the Internal Revenue Code of 1954 if—

(A) such plan would have met the requirements of such section (as amended by this section but without regard to the lack of evidence that benefits under such plan were the subject of good faith bargaining) on the day on which eligibility to participate in the plan was closed,

(B) at all times thereafter, the tuition reductions available under such plan are available on substantially the same terms to all employees eligible to participate in such plan, and

(C) the eligibility to participate in such plan closed on June 30, 1972, June 30, 1974, or December 31, 1975.

(2) For purposes of applying section 117(d)(3) of the Internal Revenue Code of 1954 to all tuition reduction plans of an employer with at least 1 such plan described in paragraph (1) of this subsection, there shall be excluded from consideration employees not included in the plan who are included in a unit of employees covered by an agreement that the Secretary of the Treasury or his delegate finds to be a collective bargaining agreement between employee representatives and 1 or more employers, if, with respect to plans other than plans described in paragraph (1), there is evidence that such benefits were the subject of good faith bargaining.

(3) Any reduction in tuition provided with respect to a full-time course of education furnished at the graduate level before July 1, 1988, shall not be included in gross income if—

(A) such reduction would not be included in gross income under the Internal Revenue Service regulations in effect on the date of the enactment of the Tax Reform Act of 1984, and

(B) such reduction is provided with respect to a student who was accepted for admission to such course of education before July 1, 1984, and began such course of education before June 30, 1985.

SEC. 1854. AMENDMENTS RELATED TO EMPLOYEE STOCK OWNERSHIP PLANS.

(a) AMENDMENTS RELATED TO SECTION 541.—

(1) Section 1042(a) (relating to nonrecognition of gain) is amended—

(A) by striking out "gain (if any) on such sale" and inserting in lieu thereof "gain (if any) on such sale which would be recognized as long-term capital gain", and

(B) by striking out "the taxpayer elects" in paragraph (1) and inserting in lieu thereof "the taxpayer or executor elects in such form as the Secretary may prescribe".

(2)(A) Section 1042(b)(2) (relating to requirement that employees must own 30 percent of stock) is amended to read as follows:

"(2) PLAN MUST HOLD 30 PERCENT OF STOCK AFTER SALE.—The plan or cooperative referred to in paragraph (1) owns (after application of section 318(a)(4)), immediately after the sale, at least 30 percent of—

"(A) each class of outstanding stock of the corporation (other than stock described in section 1504(a)(4)) which issued the qualified securities, or

"(B) the total value of all outstanding stock of the corporation (other than stock described in section 1504(a)(4)).

(B)(i) The requirement that section 1042(b) of the Internal Revenue Code of 1954 shall be applied with regard to section 318(a)(4) of such Code shall apply to sales after May 6, 1986.

(ii) In the case of sales after July 18, 1984, and before the date of the enactment of this Act, paragraph (2) of section 1042(b) of such Code shall apply as if it read as follows:

"(2) Employees must own 30 percent of stock after sale.—The plan or cooperative referred to in paragraph (1) owns, immediately after the sale, at least 30 percent of the employer securities or 30 percent of the value of employer securities (within the meaning of section 409(1) outstanding at the time of sale."

(3)(A) Section 409 is amended by redesignating subsection (n) as subsection (o) and by inserting after subsection (m) the following new subsection:

"(n) SECURITIES RECEIVED IN CERTAIN TRANSACTIONS.—

"(1) IN GENERAL.—A plan to which section 1042 applies and an eligible worker-owned cooperative (within the meaning of section 1042(c)) shall provide that no portion of the assets of the plan or cooperative attributable to (or allocable in lieu of) employer securities acquired by the plan or cooperative in a sale to which section 1042 applies may accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of section 401(a))—

"(A) during the nonallocation period, for the benefit of—

"(i) any taxpayer who makes an election under section 1042(a) with respect to employer securities,

"(ii) any individual who is related to the taxpayer (within the meaning of section 267(b)), or

"(B) for the benefit of any other person who owns (after application of section 318(a)) more than 25 percent of—

"(i) any class of outstanding stock of the corporation which issued such employer securities or of any corporation which is a member of the same controlled group of corporations (within the meaning of subsection (l)(4)) as such corporation, or

"(ii) the total value of any class of outstanding stock of any such corporation.

For purposes of subparagraph (B), section 318(a) shall be applied without regard to the employee trust exception in paragraph (2)(B)(i).

"(2) FAILURE TO MEET REQUIREMENTS.—If a plan fails to meet the requirements of paragraph (1)—

"(A) the plan shall be treated as having distributed to the person described in paragraph (1) the amount allocated to the account of such person in violation of paragraph (1) at the time of such allocation,

"(B) the provisions of section 4979A shall apply, and

"(C) the statutory period for the assessment of any tax imposed by section 4979A shall not expire before the date which is 3 years from the later of—

"(i) the 1st allocation of employer securities in connection with a sale to the plan to which section 1042 applies, or

"(ii) the date on which the Secretary is notified of such failure.

"(3) DEFINITIONS AND SPECIAL RULES.—For purposes of this subsection—

"(A) LINEAL DESCENDANTS.—Paragraph (1)(A)(ii) shall not apply to any individual if—

"(i) such individual is a lineal descendant of the taxpayer, and

"(ii) the aggregate amount allocated to the benefit of all such lineal descendants during the nonallocation period does not exceed more than 5 percent of the employer securities (or amounts allocated in lieu thereof) held by the plan which are attributable to a sale to the plan by any person related to such descendants (within the meaning of section 267(c)(4)) in a transaction to which section 1042 applied.

"(B) 25-PERCENT SHAREHOLDERS.—A person shall be treated as failing to meet the stock ownership limitation under paragraph (1)(B) if such person fails such limitation—

"(i) at any time during the 1-year period ending on the date of sale of qualified securities to the plan or cooperative, or

"(ii) on the date as of which qualified securities are allocated to participants in the plan or cooperative.

"(C) NONALLOCATION PERIOD.—The term 'nonallocation period' means the 10-year period beginning on the later of—

"(i) the date of the sale of the qualified securities, or

"(ii) the date of the plan allocation attributable to the final payment of acquisition indebtedness incurred in connection with such sale."

(B) Section 1042(b)(3) is amended by striking out paragraph (3) and redesignating paragraph (4) as paragraph (3).

(C) The amendments made by this paragraph apply to sales of securities after the date of the enactment of this Act.

(4) Section 1042(c)(1) (defining qualified securities) is amended—

(A) by striking out "securities outstanding that are" in subparagraph (A) and inserting in lieu thereof "stock outstanding that is",

(B) by inserting "and" at the end of subparagraph (A), and

(C) by striking out subparagraph (B) and redesignating subparagraph (C) as subparagraph (B).

(5)(A) Paragraph (4) of section 1042(c) (defining qualified replacement property) is amended to read as follows:

"(4) QUALIFIED REPLACEMENT PROPERTY.—

"(A) In general.—The term 'qualified replacement property' means any security issued by a domestic operating corporation which—

"(i) did not, for the taxable year preceding the taxable year in which such security was purchased, have passive investment income (as defined in section 1362(d)(3)(D)) in excess of 25 percent of the gross receipts of such corporation for such preceding taxable year, and

"(ii) is not the corporation which issued the qualified securities which such security is replacing or a member of the same controlled group of corporations (within the meaning of section 1563(a)(1)) as such corporation.

For purposes of clause (i), income which is described in section 954(c)(3) shall not be treated as passive investment income.

"(B) Operating corporation.—For purposes of this paragraph—

"(i) In general.—The term 'operating corporation' means a corporation more than 50 percent of the assets of which were, at the time the security was purchased or before the close of the placement period, used in the active conduct of the trade or business.

"(ii) Financial institutions and insurance companies.—The term 'operating corporation' shall include—

"(I) any financial institution described in section 581 or 593, and

"(II) an insurance company subject to tax under subchapter L.

"(C) Controlling and controlled corporations treated as 1 corporation.—

"(i) In general.—For purposes of applying this paragraph, if—

"(I) the corporation issuing the security owns stock representing control of 1 or more other corporations,

"(II) 1 or more other corporations own stock representing control of the corporation issuing the security, or

"(III) both,

then all such corporations shall be treated as 1 corporation.

"(ii) Control.—For purposes of clause (i), the term 'control' has the meaning given such term by section 304(c). In determining control, there shall be disregarded any qualified replacement property of the taxpayer with respect to the section 1042 sale being tested.

"(D) Security defined.—For purposes of this paragraph, the term 'security' has the meaning given such term by section 165(g)(2), except that such term shall not include any security issued by a government or political subdivision thereof."

(B) If—

(i) before January 1, 1987, the taxpayer acquired any security (as defined in section 165(g)(2) of the Internal Revenue Code of 1954) issued by a domestic corporation or by any State or political subdivision thereof,

(ii) the taxpayer treated such security as qualified replacement property for purposes of section 1042 of such Code, and

(iii) such property does not meet the requirements of section 1042(c)(4) of such Code (as amended by subparagraph (A)),

then, with respect to so much of any gain which the taxpayer treated as not recognized under section 1042(a) by reason of the acquisition of such property, the replacement period for purposes of such section shall not expire before January 1, 1987.

(6)(A) Section 1042(c) (relating to definitions and special rules) is amended by adding at the end thereof the following new paragraph:

"(7) Section not to apply to gain of C corporation.—Subsection (a) shall not apply to any gain on the sale of any qualified securities which is includible in the gross income of any C corporation."

(B) The amendment made by subparagraph (A) shall apply to sales after March 28, 1985, except that such amendment shall not apply to sales made before July 1, 1985, if made pursuant to a binding contract in effect on March 28, 1985, and at all times thereafter.

(C) The amendment made by subparagraph (A) shall not apply to any sale occurring on December 20, 1985, with respect to which—

(i) a commitment letter was issued by a bank on October 31, 1984, and

(ii) a final purchase agreement was entered into on November 5, 1985.

(D) In the case of a sale on September 27, 1985, with respect to which a preliminary commitment letter was issued by a bank on April 10, 1985, and with respect to which a commitment letter was issued by a bank on June 28, 1985, the amendment made by subparagraph (A) shall apply but such sale shall be treated as having occurred on September 27, 1986.

(7) Section 1042(d) (relating to basis of qualified replacement property) is amended by adding at the end thereof the following new flush sentence:

"Any reduction in basis under this subsection shall not be taken into account for purposes of section 1278(a)(2)(A)(ii) (relating to definition of market discount)."

(8)(A) Section 1042 is amended by redesignating subsection (e) as subsection (f) and by inserting after subsection (d) the following new subsection:

"(e) Recapture of Gain on Disposition of Qualified Replacement Property.—

"(1) In general.—If a taxpayer disposes of any qualified replacement property, then, notwithstanding any other provision of this title, gain (if any) shall be recognized to the extent of the

gain which was not recognized under subsection (a) by reason of the acquisition by such taxpayer of such qualified replacement property.

"(2) SPECIAL RULE FOR CORPORATIONS CONTROLLED BY THE TAXPAYER.—If—

"(A) a corporation issuing qualified replacement property disposes of a substantial portion of its assets other than in the ordinary course of its trade or business, and

"(B) any taxpayer owning stock representing control (within the meaning of section 304(c)) of such corporation at the time of such disposition holds any qualified replacement property of such corporation at such time,

then the taxpayer shall be treated as having disposed of such qualified replacement property at such time.

"(3) RECAPTURE NOT TO APPLY IN CERTAIN CASES.—Paragraph (1) shall not apply to any transfer of qualified replacement property—

"(A) in any reorganization (within the meaning of section 368) unless the person making the election under subsection (a)(1) owns stock representing control in the acquiring or acquired corporation and such property is substituted basis property in the hands of the transferee,

"(B) by reason of the death of the person making such election,

"(C) by gift, or

"(D) in any transaction to which section 1042(a) applies."

(B) The amendment made by subparagraph (A) shall apply to dispositions after the date of the enactment of this Act, in taxable years ending after such date.

(9)(A) Chapter 43 (relating to qualified pension, etc. plans) is amended by adding at the end thereof the following new section:

"SEC. 4979A. TAX ON CERTAIN PROHIBITED ALLOCATIONS OF QUALIFIED SECURITIES.

"(a) IMPOSITION OF TAX.—If there is a prohibited allocation of qualified securities by any employee stock ownership plan or eligible worker-owned cooperative, there is hereby imposed a tax on such allocation equal to 50 percent of the amount involved.

"(b) PROHIBITED ALLOCATION.—For purposes of this section, the term 'prohibited allocation' means—

"(1) any allocation of qualified securities acquired in a sale to which section 1042 applies which violates the provisions of section 409(n), and

"(2) any benefit which accrues to any person in violation of the provisions of section 409(n).

"(c) LIABILITY FOR TAX.—The tax imposed by this section shall be paid by—

"(1) the employer sponsoring such plan, or

"(2) the eligible worker-owned cooperative,

which made the written statement described in section 1042(b)(3)(B).

"(d) DEFINITIONS.—Terms used in this section have the same respective meaning as when used in section 4978."

(B) Subparagraph (B) of section 1042(b)(3) is amended by striking out "section 4978(a)" and inserting in lieu thereof "sections 4978 and 4979A".

(C) The table of sections for chapter 43 is amended by adding at the end thereof the following new item:

"Sec. 4979A. Tax on certain prohibited allocations of qualified securities."

(D) The amendments made by this paragraph shall apply to sales of securities after the date of the enactment of this Act.

(10) Paragraph (5) of section 1042(c) (relating to securities acquired by underwriter) is amended—

(A) by striking out "acquisition" and inserting in lieu thereof "sale",

(B) by inserting "to an employee stock ownership plan or eligible worker-owned cooperative" before "in", and

(C) by striking out "ACQUIRED" in the heading thereof and inserting in lieu thereof "SOLD".

*(11) The heading for section 1042 is amended by inserting "**EMPLOYEE**" before "**STOCK**".*

(12) The table of sections for part III of subchapter O of chapter 1 is amended by striking out the item relating to section 1042 and inserting in lieu thereof the following new item:

"Sec. 1042. Sales of stock to employee stock ownership plans or certain cooperatives."

(b) AMENDMENTS RELATED TO SECTION 542.—

(1) Paragraph (5) of section 72(e) is amended by adding at the end of subparagraph (D) the following new flush sentence:

"Any dividend described in section 404(k) which is received by a participant or beneficiary shall, for purposes of this subparagraph, be treated as paid under a separate contract to which clause (ii)(I) applies."

(2) Section 404(k) is amended—

(A) by adding at the end thereof the following new flush sentence:

"Any deduction under subparagraph (A) or (B) of paragraph (2) shall be allowed in the taxable year of the corporation in which the dividend is paid or distributed to the participant under paragraph (2).", and

(B) by striking out "during the taxable year" in the matter preceding paragraph (1).

(3) Section 404(k), as amended by paragraph (2), is amended by adding at the end thereof the following new sentence: "A plan to which this subsection applies shall not be treated as violating the requirements of section 401, 409, or 4975(e)(7) merely by reason of any distribution described in paragraph (2)."

(4) Subsection (k) of section 404 is amended by adding at the end thereof the following new sentence:

"The Secretary may disallow the deduction under this subsection for any dividend if the Secretary determines that such dividend constitutes, in substance, an avoidance of taxation."

(5) Paragraph (2) of section 404(k) is amended by striking out "participants in the plan" each place it appears and inserting in lieu thereof "participants in the plan or their beneficiaries".

(6) The amendments made by paragraphs (1) and (2) shall not apply to dividends paid before January 1, 1986, if the taxpayer treated such dividends in a manner inconsistent with such amendments on a return filed with the Secretary before the date of the enactment of this Act.

(c) AMENDMENTS RELATED TO SECTION 543.—

(1) Subparagraph (B) of section 291(e)(1) (defining financial institution preference item) is amended by adding at the end thereof the following new clause:

"(iv) SPECIAL RULES FOR OBLIGATIONS TO WHICH SECTION 133 APPLIES.—In the case of an obligation to which section 133 applies, interest on such obligation shall not be treated as exempt from taxes for purposes of this subparagraph."

(2)(A) Section 133 (relating to exemption for interest on certain loans used to acquire employer securities) is amended by adding at the end thereof the following new subsection:

"(d) APPLICATION WITH SECTION 483 AND ORIGINAL ISSUE DISCOUNT RULES.—In applying section 483 and subpart A of part V of subchapter P to any obligation to which this section applies, appropriate adjustments shall be made to the applicable Federal rate to take into account the exclusion under subsection (a)."

(B) Section 7872(f) is amended by adding at the end thereof the following new paragraph:

"(11) SPECIAL RULE FOR CERTAIN EMPLOYER SECURITY LOANS.—This section shall not apply to any loan between a corporation (or any member of the controlled group of corporations which includes such corporation) and an employee stock ownership plan described in section 4975(e)(7) to the extent that the interest rate on such loan is equal to the interest rate paid on a related securities acquisition loan (as described in section 133(b)) to such corporation."

(C) Section 133(b)(2) is amended by adding at the end thereof the following new flush sentence:

"For purposes of this paragraph, subparagraphs (A) and (B) shall not apply to any loan which, but for such subparagraphs, would be a securities acquisition loan if such loan was not originated by the employer of any employees who are covered by the plan or by any member of the controlled group of corporations which includes such employer, except that this section shall not apply to any interest received on such loan during such time as such loan is held by such employer (or any member of such controlled group)."

(D) Section 133(b) is amended by redesignating paragraph (3) as paragraph (4) and by adding after paragraph (2) the following new paragraph:

"(3) TERMS APPLICABLE TO CERTAIN SECURITIES ACQUISITION LOANS.—A loan to a corporation shall not fail to be treated as a securities acquisition loan merely because the proceeds of such loan are lent to an employee stock ownership plan sponsored by such corporation (or by any member of the controlled group of

corporations which includes such corporation) if such loan includes—

"(A) repayment terms which are substantially similar to the terms of the loan of such corporation from a lender described in subsection (a), or

"(B) repayment terms providing for more rapid repayment of principal or interest on such loan but only if—

"(i) allocations under the plan attributable to such repayment do not discriminate in favor of highly compensated employees (within the meaning of section 414(q)), and

"(ii) the total commitment period of such loan to the corporation does not exceed 7 years."

(d) Amendments Related to Section 544.—

(1)(A) Section 2210(a) (relating to liability for payment of estate tax in case of transfer of employer securities to an ESOP or worker cooperative) is amended by striking out "and" at the end of paragraph (1), by redesignating paragraph (2) as paragraph (3), and by inserting after paragraph (1) the following new paragraph:

"(2) the executor of the estate of the decedent may (without regard to this section) make an election under section 6166 with respect to that portion of the tax imposed by section 2001 which is attributable to employer securities, and".

(B) The amendment made by subparagraph (A) shall apply to the estates of decedents dying after September 27, 1985.

(2) Section 2210(c) (relating to installment payments) is amended by adding at the end thereof the following new paragraph:

"(3) Special rules for application of section 6166(g).—In the case of any transfer of employer securities to an employee stock ownership plan or eligible worker-owned cooperative to which this section applies—

"(A) Transfer does not trigger acceleration.—Such transfer shall not be treated as a disposition or withdrawal to which section 6166(g) applies.

"(B) Separate application to estate and plan interests.—Section 6166(g) shall be applied separately to the interests held after such transfer by the estate and such plan or cooperative.

"(C) Required distribution not taken into account.—In the case of any distribution of such securities by such plan which is described in section 4978(d)(1)—

"(i) such distribution shall not be treated as a disposition or withdrawal for purposes of section 6166(g), and

"(ii) such securities shall not be taken into account in applying section 6166(g) to any subsequent disposition or withdrawal."

(3) Section 2210(g) (relating to definitions) is amended by adding at the end thereof the following new paragraph:

"(5) Tax imposed by section 2001.—The term 'tax imposed by section 2001' includes any interest, penalty, addition to tax, or

additional amount relating to any tax imposed by section 2001."

(4) Section 2210(c)(1) is amended by inserting "any authorized officer of" before "the cooperative" in the matter following subparagraph (B).

(5) Section 2210(d) (relating to guarantee of payments) is amended—

(A) by inserting "and any eligible worker-owned cooperative" before "shall guarantee" in the matter following paragraph (2),

(B) by striking out "such plan" and inserting in lieu thereof "such plan or cooperative, respectively,", and

(C) by striking out ", including any interest payable under section 6601 which is attributable to such amount".

(6) Section 2210(g)(3) is amended by striking out "section 1041(b)(2)" and inserting in lieu thereof "section 1042(c)(2)".

(e) Amendments Related to Section 545.—

(1) Section 4978(a)(1) (relating to tax on disposition of securities to which section 1042 applies before close of minimum holding period) is amended by striking out "then" and inserting in lieu thereof "than".

(2) Section 4978(b)(1) is amended by striking out "paragraph (1)" and inserting in lieu thereof "subsection (a)".

(3) Section 4978(c) is amended by striking out "section 1042(a)(2)(B)" and inserting in lieu thereof "section 1042(b)(3)".

(4) Section 4978(d)(1)(C) is amended by striking out "section 72(m)(5)" and inserting in lieu thereof "section 72(m)(7)".

(5) Section 4978(e)(2) is amended by striking out "section 1042(b)(1)" and inserting in lieu thereof "section 1042(c)(1)".

(6) Section 4978(e)(3) is amended by striking out "section 1042(b)(1)" and inserting in lieu thereof "section 1042(c)(2)".

(7) Section 4978(d) (relating to dispositions to which section does not apply) is amended by adding at the end thereof the following new paragraph:

"(3) Liquidation of corporation into cooperative.—In the case of any exchange of qualified securities pursuant to the liquidation of the corporation issuing qualified securities into the eligible worker-owned cooperative in a transaction which meets the requirements of section 332 (determined by substituting '100 percent' for '80 percent' each place it appears in section 332(b)(1)), such exchange shall not be treated as a disposition for purposes of this section."

(f) Other Amendments.—

(1)(A) Section 409(e) (relating to voting rights) is amended by adding at the end thereof the following new paragraph:

"(5) 1 vote per participant.—A plan meets the requirements of paragraph (2) or (3) with respect to an issue if—

"(A) the plan permits each participant 1 vote with respect to such issue, and

"(B) the trustee votes the shares held by the plan in the proportion determined after application of subparagraph (A)."

(B) Paragraph (3) of section 409(e) (relating to requirement for other employers) is amended by striking out all that follows

"with respect to" and inserting in lieu thereof the following: "any corporate matter which involves the voting of such shares with respect to the approval or disapproval of any corporate merger or consolidation, recapitalization, reclassification, liquidation, dissolution, sale of substantially all assets of a trade or business, or such similar transaction as the Secretary may prescribe in regulations."

(C) Paragraphs (2) and (3) of section 409(e) are amended by striking out "employer securities" and inserting in lieu thereof "securities of the employer".

(D) Paragraphs (2) and (3) of section 409(e) are amended by inserting "or beneficiary" after "participant" each place it appears.

(2) Section 402 is amended by adding at the end thereof the following new section:

"(g) EFFECT OF DISPOSITION OF STOCK BY PLAN ON NET UNREALIZED APPRECIATION.—

"(1) IN GENERAL.—For purposes of subsection (a)(1) or (e)(4)(J), in the case of any transaction to which this subsection applies, the determination of net unrealized appreciation shall be made without regard to such transaction.

"(2) TRANSACTION TO WHICH SUBSECTION APPLIES.—This subsection shall apply to any transaction in which—

"(A) the plan trustee exchanges the plan's securities of the employer corporation for other such securities, or

"(B) the plan trustee disposes of securities of the employer corporation and uses the proceeds of such disposition to acquire securities of the employer corporation within 90 days (or such longer period as the Secretary may prescribe), except that this subparagraph shall not apply to any employee with respect to whom a distribution of money was made during the period after such disposition and before such acquisition."

(3)(A) Section 4975(e)(7) is amended by inserting ", section 409(o), and, if applicable, section 409(n)" after "section 409(h)".

(B) Section 1042(b)(3)(B) is amended by inserting "and 4979A" after "section 4978(a)".

(C) Section 409(h)(2) is amended by striking out "in cash" in the second sentence thereof and inserting in lieu thereof "in cash, except that such plan may distribute employer securities subject to a requirement that such securities may be resold to the employer under the terms which meet the requirements of section 409(o)".

(4)(A) The amendments made by paragraph (1)(A) and (3) shall take effect on the date of the enactment of this Act.

(B) The amendments made by subparagraphs (B), (C), and (D) of paragraph (1) shall apply after December 31, 1986, to stock acquired after December 31, 1979.

(C) The amendments made by paragraph (2) shall apply to any transaction occurring after December 31, 1984, except that in the case of any transaction occurring before the date of the enactment of this Act, the period under which proceeds are required to be invested under section 402(g) of the Internal Revenue Code of 1954 (as added by paragraph (2)) shall not end

before the earlier of 1 year after the date of such transaction or 180 days after the date of the enactment of this Act.

SEC. 1855. AMENDMENTS RELATED TO MISCELLANEOUS EMPLOYEE BENEFIT PROVISIONS.

(a) AMENDMENT RELATED TO SECTION 555 OF THE ACT.—Subsection (c) of section 555 of the Tax Reform Act of 1984 (relating to technical amendments to the incentive stock option provisions) is amended—

(1) by striking out "subsection (a)" in paragraph (1) and inserting in lieu thereof "subsection (a)(1)",

(2) by striking out "subsection (b)" in paragraph (2) and inserting in lieu thereof "subsection (a)(2)",

(3) by striking out "after March 20, 1984," in paragraph (2), and

(4) by striking out "subsection (c)" in paragraph (3) and inserting in lieu thereof "subsection (b)".

(b) AMENDMENT RELATED TO SECTION 556 OF THE ACT.—Section 556 of the Tax Reform Act of 1984 is amended by striking out so much of such section as precedes paragraph (1) thereof and inserting in lieu thereof the following:

"SEC. 556. TIME FOR MAKING CERTAIN SECTION 83(b) ELECTIONS.

"In the case of any transfer of property in connection with the performance of services on or before November 18, 1982, the election permitted by section 83(b) of the Internal Revenue Code of 1954 may be made, notwithstanding paragraph (2) of such section 83(b), with the income tax return for any taxable year ending after July 18, 1984, and beginning before the date of the enactment of the Tax Reform Act of 1986 if—".

CHAPTER 6—AMENDMENTS RELATED TO TITLE VI OF THE ACT

SEC. 1861. AMENDMENTS RELATED TO SECTION 611 OF THE ACT.

(a) EXTENSION OF TIME FOR SUBMITTING POLICY STATEMENT.—Paragraph (5) of section 103A(j) is amended by adding at the end thereof the following new subparagraph:

"(C) EXTENSION OF TIME.—The Secretary may grant an extension of time for the publishing of a report described in subparagraph (B) or the submittal of such report to the Secretary if there is reasonable cause for the failure to publish or submit such report in a timely fashion."

(b) DEFINITION OF QUALIFIED VETERAN.—Subparagraph (B) of section 103A(o)(4) (defining qualified veteran) is amended by striking out "January 1, 1985" and inserting in lieu thereof "January 31, 1985".

(c) CLARIFICATION OF GOOD FAITH EFFORT PROVISIONS.—

(1) Subparagraph (B) of section 103A(c)(2) (defining qualified mortgage issue) is amended by striking out "and (j)" and inserting in lieu thereof "and (j)(1) and (2)".

(2) Subparagraph (C) of section 103A(c)(2) is amended by striking out "and (i)" and inserting in lieu thereof "(i), and (j) (3), (4), and (5)".

SEC. 1862. AMENDMENT RELATED TO SECTION 612 OF THE ACT.

(a) Requirements for Qualified Mortgage Credit Certificate Program.—Subclause (V) of section 25(c)(2)(A)(iii) (defining qualified mortgage credit certificate program) is amended by striking out "paragraph (1) of subsection (j)" and inserting in lieu thereof "subsection (j), other than paragraph (2) thereof".

(b) Good Faith Effort Rules Made Applicable.—Subparagraph (A) of section 25(c)(2) (defining qualified mortgage credit certificate program) is amended by adding at the end thereof the following new sentence:

> "Under regulations, rules similar to the rules of subparagraphs (B) and (C) of section 103A(c)(2) shall apply to the requirements of this subparagraph."

(c) Carryforward of Excess Credit.—Subparagraph (B) of section 25(e)(1) (relating to carryforward of unused credit) is amended to read as follows:

> "(B) Limitation.—The amount of the unused credit which may be taken into account under subparagraph (A) for any taxable year shall not exceed the amount (if any) by which the applicable tax limit for such taxable year exceeds the sum of—
>
> "(i) the credit allowable under subsection (a) for such taxable year determined without regard to this paragraph, and
>
> "(ii) the amounts which, by reason of this paragraph, are carried to such taxable year and are attributable to taxable years before the unused credit year."

(d) Clerical Amendments.—

(1) Subparagraph (B) of section 25(a)(1) is amended by striking out "paid or incurred" and inserting in lieu thereof "paid or accrued".

(2) Subchapter B of chapter 68 is amended by redesignating the section 6708 which relates to penalties with respect to mortgage credit certificates as section 6709.

(3) The table of sections for subchapter B of chapter 68 is amended by striking out the item relating to the section 6708 which relates to penalties with respect to mortgage credit certificates and inserting in lieu thereof the following:

"Sec. 6709. Penalties with respect to mortgage credit certificates."

SEC. 1863. AMENDMENT RELATED TO SECTION 613 OF THE ACT.

(a) General Rule.—Section 613 of the Tax Reform Act of 1984 (relating to authority to borrow from Federal Financing Bank) is amended to read as follows:

"SEC. 613. ADVANCE REFUNDING OF CERTAIN VETERANS' MORTGAGE BONDS PERMITTED.

"(a) In General.—Notwithstanding section 103A(n) of the Internal Revenue Code of 1954, an issuer of applicable mortgage bonds may issue advance refunding bonds with respect to such applicable mortgage bonds.

"(b) Limitation on Amount of Advanced Refunding.—

"(1) In general.—The amount of advanced refunding bonds which may be issued under subsection (a) shall not exceed the lesser of—

"(A) $300,000,000, or

"(B) the excess of—

"(i) the projected aggregate payments of principal on the applicable mortgage bonds during the 15-fiscal year period beginning with fiscal year 1984, over

"(ii) the projected aggregate payments during such period of principal on mortgages financed by the applicable mortgage bonds.

"(2) ASSUMPTIONS USED IN MAKING PROJECTION.—The computation under paragraph (1)(B) shall be made by using the following percentages of the prepayment experience of the Federal Housing Administration in the State or region in which the issuer of the advance refunding bonds is located:

"Fiscal Year:	*Percentage:*
1984	*15*
1985	*20*
1986	*25*
1987 and thereafter	*30.*

"(c) DEFINITIONS.—For purposes of this section.—

"(1) APPLICABLE MORTGAGE BONDS.—The term 'applicable mortgage bonds' means any qualified veterans' mortgage bonds issued as part of an issue—

"(A) which was outstanding on December 31, 1981,

"(B) with respect to which the excess determined under subsection (b)(1)(B) exceeds 12 percent of the aggregate principal amount of such bonds outstanding on July 1, 1983,

"(C) with respect to which the amount of the average annual prepayments during fiscal years 1981, 1982, and 1983 was less than 2 percent of the average of the loan balances as of the beginning of each of such fiscal years, and

"(D) which, for fiscal year 1983, had a prepayment experience rate that did not exceed 20 percent of the prepayment experience rate of the Federal Housing Administration in the State or region in which the issuer is located.

"(2) QUALIFIED VETERANS' MORTGAGE BONDS.—The term 'qualified veterans' mortgage bonds' has the meaning given to such term by section 103A(c)(3) of the Internal Revenue Code of 1954.

"(3) FISCAL YEAR.—The term 'fiscal year' means the fiscal year of the State."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect on the date of the enactment of this Act; except that such amendment shall not apply with respect to any loan made by the Federal Financing Bank to the State of Oregon pursuant to a credit agreement entered into on April 16, 1985 (as such agreement was in effect on such date). The Secretary of the Treasury shall guarantee any loan made by the Federal Financing Bank to the State of Oregon pursuant to such agreement.

SEC. 1864. AMENDMENTS RELATED TO SECTION 621 OF THE ACT.

(a) SPECIAL RULE FOR FACILITIES LOCATED OUTSIDE THE STATE.—

(1) IN GENERAL.—Subsection (n) of section 103 (relating to limitation on aggregate amount of private activity bonds issued

during any calendar year) is amended by adding at the end thereof the following new paragraph:

"(13) FACILITY MUST BE LOCATED WITHIN STATE.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), no portion of the State ceiling applicable to any State for any calendar year may be used with respect to financing for a facility located outside such State.

"(B) EXCEPTION FOR CERTAIN FACILITIES WHERE STATE WILL GET PROPORTIONATE SHARE OF BENEFITS.—Subparagraph (A) shall not apply to any issue described in subparagraph (E), (G), or (H) of subsection (b)(4) if the issuer establishes that the State's share of the use of the facility (or its output) will equal or exceed the State's share of the private activity bonds issued to finance the facility."

(2) EFFECTIVE DATE.—

(A) Except as provided in subparagraph (B), the amendment made by paragraph (1) shall apply to obligations issued after the date of the enactment of this Act in taxable years ending after such date.

(B) At the election of the issuer (made at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe), the amendment made by paragraph (1) shall apply to any obligation issued on or before the date of the enactment of this Act.

(b) CLARIFICATION OF AUTHORITY FOR DIFFERENT ALLOCATION.—Subparagraphs (A) and (B)(i) of section 103(n)(6) (relating to State may provide for different allocation) are each amended by striking out "governmental units" and inserting in lieu thereof "governmental units or other authorities".

(c) CLARIFICATION OF EXCEPTION FOR CERTAIN FACILITIES.—Clause (i) of section 103(n)(7)(C) (relating to exception for certain facilities described in section 103(b)(4) (C) or (D)) is amended by striking out "the property described in such subparagraph" and inserting in lieu thereof "all of the property to be financed by the obligation".

(d) INFORMATION REPORTING ON ALLOCATION OF PRIVATE ACTIVITY BOND LIMIT.—Paragraph (2) of section 103(l) (relating to information reporting requirements for certain bonds) is amended by striking out "and" at the end of subparagraph (D), by striking out the period at the end of subparagraph (E) and inserting in lieu thereof ", and", and by adding at the end thereof the following new subparagraph:

"(F) if such obligation is a private activity bond (as defined in subsection (n)(7)), such information as the Secretary may require for purposes of determining whether the requirements of subsection (n) are met with respect to such obligation."

(e) CLARIFICATION OF CARRYFORWARD OF UNUSED BOND AUTHORITY.—

(1) Subparagraph (B) of section 103(n)(10) (relating to election must specify project) is amended—

(A) by striking out "specify the project" in clause (i) and inserting in lieu thereof "identify (with reasonable specificity) the project", and

(B) by striking out "SPECIFY PROJECT" in the subparagraph heading and insert in lieu thereof "IDENTIFY PROJECT".

(2) Subparagraph (D) of section 103(n)(10) is amended by striking out "any specification" and inserting in lieu thereof "any identification or specification".

SEC. 1865. AMENDMENT RELATED TO SECTION 622 OF THE ACT.

(a) Clerical Amendment.—Subparagraph (A) of section 103(h)(5) (relating to certain obligations subsidized under energy program) is amended by striking out "the United States,".

(b) Treatment of Certain Guarantees by Farmers Home Administration.—An obligation shall not be treated as federally guaranteed for purposes of section 103(h) of the Internal Revenue Code of 1954 by reason of a guarantee by the Farmers Home Administration if—

(1) such guarantee is pursuant to a commitment made by the Farmers Home Administration before July 1, 1984, and

(2) such obligation is issued to finance a convention center project in Carbondale, Illinois.

(c) Treatment of Certain Obligations Used to Finance Solid Waste Disposal Facility.—

(1) In general.—Any obligation which is part of an issue a substantial portion of the proceeds of which is to be used to finance a solid waste disposal facility described in paragraph (2) shall not, for purposes of section 103(h) of the Internal Revenue Code of 1954, be treated as an obligation which is federally guaranteed by reason of the sale of fuel, steam, electricity, or other forms of usable energy to the Federal Government or any agency or instrumentality thereof.

(2) Solid waste disposal facility.—A solid waste disposal facility is described in this paragraph if such facility is described in section 103(b)(4)(E) of such Code and—

(A) if—

(i) a public State authority created pursuant to State legislation which took effect on July 1, 1980, took formal action before October 19, 1983, to commit development funds for such facility,

(ii) such authority issues obligations for such facility before January 1, 1988, and

(iii) expenditures have been made for the development of such facility before October 19, 1983,

(B) if—

(i) such facility is operated by the South Eastern Public Service Authority of Virginia, and

(ii) on December 20, 1984, the Internal Revenue Service issued a ruling concluding that a portion of the obligations with respect to such facility would not be treated as federally guaranteed under section 103(h) of such Code by reason of the transitional rule contained in section 631(c)(3)(A)(i) of the Tax Reform Act of 1984,

(C) if—

(i) a political subdivision of a State took formal action on April 1, 1980, to commit development funds for such facility,

(ii) such facility has a contract to sell steam to a naval base,

(iii) such political subdivision issues obligations for such facility before January 1, 1988, and

(iv) expenditures have been made for the development of such facility before October 19, 1983, or

(D) if—

(i) such facility is a thermal transfer facility,

(ii) is to be built and operated by the Elk Regional Resource Authority, and

(iii) is to be on land leased from the United States Air Force at Arnold Engineering Development Center near Tullahoma, Tennessee.

(3) LIMITATIONS.—

(A) In the case of a solid waste disposal facility described in paragraph (2)(A), the aggregate face amount of obligations to which paragraph (1) applies shall not exceed $65,000,000.

(B) In the case of a solid waste disposal facility described in paragraph (2)(B), the aggregate face amount of obligations to which paragraph (1) applies shall not exceed $20,000,000. Such amount shall be in addition to the amount permitted under the Internal Revenue Service ruling referred to in paragraph (2)(B)(ii).

(C) In the case of a solid waste disposal facility described in paragraph (2)(C), the aggregate face amount of obligations to which paragraph (1) applies shall not exceed $75,000,000.

(D) In the case of a solid waste disposal facility described in paragraph (2)(D), the aggregate face amount of obligations to which paragraph (1) applies shall not exceed $25,000,000.

SEC. 1866. TRANSITIONAL RULE FOR LIMIT ON SMALL ISSUE EXCEPTION.

The amendment made by section 623 of the Tax Reform Act of 1984 shall not apply to any obligation issued to refund another tax-exempt IDB to which the amendment made by such section 623 did not apply if—

(1) the refunding obligation has a maturity date not later than the maturity date of the refunded obligation,

(2) the amount of the refunding obligation does not exceed the amount of the refunded obligation,

(3) the interest rate on the refunding obligation is lower than the interest rate on the refunded issue, and

(4) the proceeds of the refunding obligation are used to redeem the refunded obligation not later than 30 days after the date of the issuance of the refunding obligation.

For purposes of the preceding sentence, the term "tax-exempt IDB" means any industrial development bond (as defined in section 103(b) of the Internal Revenue Code of 1954) the interest on which is exempt from tax under section 103(a) of such Code.

SEC. 1867. AMENDMENTS RELATED TO SECTION 624 OF THE ACT.

(a) Paragraph (2) of section 624(c) of the Tax Reform Act of 1984 (relating to effective date for limitations on arbitrage on nonpurpose obligations) is amended by striking out "by the Essex County Port Authority of New York and New Jersey as part of an issue approved" and inserting in lieu thereof "for the Essex County New Jersey Resource Recovery Project authorized by the Port Authority of New York and New Jersey on November 10, 1983, as part of an agreement approved".

(b) The amendment made by section 624 of the Tax Reform Act of 1984 shall not apply to obligations issued with respect to the Downtown Muskogee Revitalization Project for which a UDAG grant was preliminarily approved on May 5, 1981, if—

(1) such obligation is issued before January 1, 1986, or

(2) such obligation is issued after such date to provide additional financing for such project except that the aggregate amount of obligations to which this subsection applies shall not exceed $10,000,000.

SEC. 1868. AMENDMENT RELATED TO SECTION 625 OF THE ACT.

Subparagraph (C) of section 625(a)(3) of the Tax Reform Act of 1984 (relating to arbitrage regulations) is amended by striking out "obligation issued exclusively" and inserting in lieu thereof "obligation (or series of refunding obligations) issued exclusively".

SEC. 1869. AMENDMENTS RELATED TO SECTION 626 OF THE ACT.

(a) CHANGE IN DEFINED TERM.—Subsection (o) of section 103 (relating to denial of tax exemption for consumer loan bonds) is amended—

(1) by striking out "consumer loan bond" each place it appears and inserting in lieu thereof "private loan bond",

(2) by striking out "CONSUMER LOAN BONDS" in the subsection heading and inserting in lieu thereof "PRIVATE LOAN BONDS", and

(3) by striking out "CONSUMER LOAN BONDS" in the heading for paragraph (2) and inserting in lieu thereof "PRIVATE LOAN BONDS".

(b) CLERICAL AMENDMENTS.—

(1) Clause (ii) of section 103(o)(2)(C) (relating to excluded loans) is amended by striking out "subsection (c)(6)(G)(i)" and inserting in lieu thereof "subsection (c)(6)(H)(i)".

(2) Section 103 is amended by redesignating the subsection (o) (relating to cross references) as subsection (p).

(c) TRANSITIONAL RULES.—

(1) TREATMENT OF CERTAIN OBLIGATIONS ISSUED BY THE CITY OF BALTIMORE.—Obligations issued by the city of Baltimore, Maryland, after June 30, 1985, shall not be treated as private loan bonds for purposes of section 103(o) of the Internal Revenue Code of 1954 (or as private activity bonds for purposes of section 103 and part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1986, as amended by title XIII of this Act) by reason of the use of a portion of the proceeds of such obligations to finance or refinance temporary advances made by the city of Baltimore in connection with loans to persons who

are not exempt persons (within the meaning of section 103(b)(3) of such Code) if—

(A) such obligations are not industrial development bonds (within the meaning of section 103(b)(2) of the Internal Revenue Code of 1954),

(B) the portion of the proceeds of such obligations so used is attributable to debt approved by voter referendum on or before November 2, 1982,

(C) the loans to such nonexempt persons were approved by the Board of Estimates of the city of Baltimore on or before October 19, 1983, and

(D) the aggregate amount of such temporary advances financed or refinanced by such obligations does not exceed $27,000,000.

(2) WHITE PINE POWER PROJECT.—The amendment made by section 626(a) of the Tax Reform Act of 1984 shall not apply to any obligation issued during 1984 to provide financing for the White Pine Power Project in Nevada.

(3) TAX INCREMENT BONDS.—The amendment made by section 626(a) of the Tax Reform Act of 1984 shall not apply to any tax increment financing obligation issued before August 16, 1986, if—

(A) substantially all of the proceeds of the issue are to be used to finance—

(i) sewer, street, lighting, or other governmental improvements to real property,

(ii) the acquisition of any interest in real property pursuant to the exercise of eminent domain, the preparation of such property for new use, or the transfer of such interest to a private developer, or

(iii) payments of reasonable relocation costs of prior users of such real property,

(B) all of the activities described in subparagraph (A) are pursuant to a redevelopment plan adopted by the issuing authority before the issuance of such issue,

(C) repayment of such issue is secured exclusively by pledges of that portion of any increase in real property tax revenues (or their equivalent) attributable to the redevelopment resulting from the issue, and

(D) none of the property described in subparagraph (A) is subject to a real property or other tax based on a rate or valuation method which differs from the rate and valuation method applicable to any other similar property located within the jurisdiction of the issuing authority.

(4) EASTERN MAINE ELECTRIC COOPERATIVE.—The amendment made by section 626(a) of the Tax Reform Act of 1984 shall not apply to obligations issued by Massachusetts Municipal Wholesale Electric Company Project No. 6 if—

(A) such obligation is issued before January 1, 1986,

(B) such obligation is issued after such date to refund a prior obligation for such project, except that the aggregate amount of obligations to which this subparagraph applies shall not exceed $100,000,000, or

(C) such obligation is issued after such date to provide additional financing for such project except that the aggregate amount of obligations to which this subparagraph applies shall not exceed $45,000,000.

Subparagraph (B) shall not apply to any obligation issued for the advance refunding of any obligation.

(5) CLARIFICATION OF TRANSITIONAL RULE FOR CERTAIN STUDENT LOAN PROGRAMS.—Subparagraph (A) of section 626(b)(2) of the Tax Reform Act of 1984 is amended by striking out "$11 million" in the table contained in such subparagraph and inserting in lieu thereof "$70 million".

(6) TREATMENT OF OBLIGATIONS TO FINANCE ST. JOHNS RIVER POWER PARK.—

(A) IN GENERAL.—The amendment made by section 626(a) of the Tax Reform Act of 1984 shall not apply to any obligation issued to finance the project described in subparagraph (B) if—

(i) such obligation is issued before September 27, 1985,

(ii) such obligation is issued after such date to refund a prior tax exemption obligation for such project, the amount of such obligation does not exceed the outstanding amount of the refunded obligation, and such prior tax exempt obligation is retired not later than the date 30 days after the issuance of the refunding obligation, or

(iii) such obligation is issued after such date to provide additional financing for such project except that the aggregate amount of obligations to which this clause applies shall not exceed $150,000,000.

Clause (ii) shall not apply to any obligation issued for the advance refunding of any obligation.

(B) DESCRIPTION OF PROJECT.—The project described in this subparagraph in the St. Johns River Power Park system in Florida which was authorized by legislation enacted by the Florida Legislature in February of 1982.

SEC. 1870. AMENDMENT RELATED TO SECTION 627 OF THE ACT.

Subparagraph (A) of section 103(b)(16) (relating to limitation on use for land acquisition) is amended by striking out "clause (i)" in the last sentence and inserting in lieu thereof "clause (ii)".

SEC. 1871. AMENDMENTS RELATED TO SECTION 628 OF THE ACT.

(a) CERTAIN RESTRICTIONS APPLY TO EXEMPTIONS NOT CONTAINED IN INTERNAL REVENUE CODE OF 1954.—

(1) IN GENERAL.—Paragraph (1) of section 103(m) (relating to obligations exempt other than under this title) is amended by striking out "(k), (l), and (n)" and inserting in lieu thereof "(j), (k), (l), (n), and (o)".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to obligations issued after March 28, 1985, in taxable years ending after such date.

(b) CONFORMING AMENDMENTS TO REPEAL OF ADVANCE REFUNDING OF QUALIFIED PUBLIC FACILITIES.—Paragraphs (13), (14)(A), and

(17)(A) of section 103(b) are each amended by striking out "(6), and (7)" and inserting in lieu thereof "and (6)".

SEC. 1872. AMENDMENTS RELATED TO SECTION 631 OF THE ACT.

(a) Clarification of General Effective Date.—

(1) Paragraph (1) of section 631(c) of the Tax Reform Act of 1984 (relating to effective date for other provisions relating to tax-exempt bonds) is amended by striking out "made by this subtitle" and inserting in lieu thereof "made by sections 622, 623, 627, and 628 (c), (d), and (e) (and the provisions of sections 625(c), 628(f), and 629(b))".

(2)(A) Subparagraph (A) of section 631(c)(3) of the Tax Reform Act of 1984 is amended by striking out "amendments made by this subtitle (other than section 621)" and inserting in lieu thereof "amendments (and provisions) referred to in paragraph (1)".

(B) Effective with respect to obligations issued after March 28, 1985, subparagraph (A) of section 631(c)(3) of the Tax Reform Act of 1984 is amended by striking out clauses (i) and (ii) and inserting in lieu thereof the following:

"(i) the original use of which commences with the taxpayer and the construction, reconstruction, or rehabilitation of which began before October 19, 1983, and was completed on or after such date,

"(ii) the original use of which commences with the taxpayer and with respect to which a binding contract to incur significant expenditures for construction, reconstruction, or rehabilitation was entered into before October 19, 1983, and some of such expenditures are incurred on or after such date, or

"(iii) acquired after October 19, 1983, pursuant to a binding contract entered into on or before such date."

(3) Paragraph (3) of section 631(c) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new subparagraph:

"(C) Exception.—Subparagraph (A) shall not apply with respect to the amendment made by section 628(e) and the provisions of sections 628(f) and 629(b)."

(4) Subparagraph (B) of section 631(c)(3) of the Tax Reform Act of 1984 is amended by striking out "subsection (b)(2)(A)" and inserting in lieu thereof "subsection (b)(2)".

(b) Special Rule for Health Club Facilities.—Subsection (c) of section 631 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraph:

"(5) Special rule for health club facilities.—In the case of any health club facility, with respect to the amendment made by section 627(c)—

"(A) paragraph (1) shall be applied by substituting 'April 12, 1984' for 'December 31, 1983', and

"(B) paragraph (3) shall be applied by substituting 'April 13, 1984' for 'October 19, 1983' each place it appears."

(c) Treatment of Certain Solid Waste Disposal Facilities.—

(1) In general.—Subsection (d) of section 631 of the Tax Reform Act of 1984 (relating to provisions of subtitle not to

apply to certain property) is amended by adding at the end thereof the following:

"(5) Any solid waste disposal facility described in section 103(b)(4)(E) of the Internal Revenue Code of 1954 if—

"(A) a city government, by resolutions adopted on April 10, 1980, and December 27, 1982, took formal action to authorize the submission of a proposal for a feasibility study for such facility and to authorize the presentation to the Department of the Army (U.S. Army Missile Command) of a proposed agreement to jointly pursue construction and operation of such facility,

"(B) such city government (or a public authority on its behalf) issues obligations for such facility before January 1, 1988, and

"(C) expenditures have been made for the development of such facility before October 19, 1983. Notwithstanding the foregoing provisions of this subsection, the amendments made by section 624 (relating to arbitrage) shall apply to obligations issued to finance property described in paragraph (5)."

(2) CONFORMING AMENDMENT.—Paragraph (1) of section 632(a) of the Tax Reform Act of 1984 is hereby repealed.

SEC. 1873. AMENDMENTS RELATED TO SECTION 632 OF THE ACT.

(a) CLERICAL AMENDMENT.—Subsection (a) of section 632 of the Tax Reform Act of 1984 is amended by striking out "section 623" in the matter preceding paragraph (1) thereof and inserting in lieu thereof "section 624".

(b) CERTAIN OBLIGATIONS NOT TREATED AS PRIVATE LOAN BONDS.—Subsection (d) of section 632 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new sentence: "The amendment made by section 626 shall not apply to any obligations described in the preceding sentence."

(c) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE HYDROELECTRIC GENERATING FACILITY.—If—

(1) obligations are to be issued in an amount not to exceed $9,500,000 to finance the construction of an approximately 4 megawatt hydroelectric generating facility owned and operated by the city of Hastings, Minnesota, and located on United States Army Corps of Engineers lock and dam No. 2 or are issued to refund any of such obligations,

(2) substantially all of the electrical power generated by such facility is to be sold to a nongovernmental person pursuant to a long-term power sales agreement in accordance with the Public Utilities Regulatory Policies Act of 1978, and

(3) the initially issued obligations are issued on or before December 31, 1986, and any of such refunding obligations are issued on or before December 31, 1996,

then the person referred to in paragraph (2) shall not be treated as the principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the Internal Revenue Code of 1954.

(d) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE HYDROELECTRIC GENERATING FACILITY.—If—

(1) obligations are to be issued in an amount not to exceed $6,500,000 to finance the construction of an approximately 2.6 megawatt hydroelectric generating facility located on the Schroon River in Warren County, New York, near Warrensburg, New York,

(2) such facility has a Federal Energy Regulatory Commission project number 8719-0000 under a preliminary permit issued on November 8, 1985, and

(3) substantially all of the electrical power generated by such facility is to be sold to a nongovernmental person pursuant to a long-term power sales agreement in accordance with the Public Utilities Regulatory Policies Act of 1978,

then the person referred to in paragraph (3) shall not be treated as the principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the Internal Revenue Code of 1954.

(e) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE HYDROELECTRIC GENERATING FACILITIES.—If—

(1) obligations in the amount of $6,000,000 issued on November 30, 1984, to finance the construction of an approximately 1.0 megawatt hydroelectric generating facility and an approximately .6 megawatt hydroelectric generating facility, both of which are located near Los Banos, California,

(2) such facilities have Federal Energy Regulatory Commission project numbers 5129-001 and 5128-001, respectively, under license exemptions issued on December 6, 1983, and

(3) substantially all of the electrical power generated by such facility is to be sold to a nongovernmental person pursuant to a long-term power sales agreement in accordance with the Public Utilities Regulatory Policies Act of 1978,

then the person referred to in paragraph (3) shall not be treated as the principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the Internal Revenue Code of 1954.

(f) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE METHANE RECOVERY ELECTRIC GENERATING FACILITIES.—If—

(1) obligations are to be issued in an amount not to exceed $3,000,000 to finance the construction of a methane recovery electric generating facility located on a sanitary landfill near Richmond, California, and

(2) substantially all of the electrical power generated by such facility is to be sold to a nongovernmental person pursuant to a long-term power sales agreement entered into on April 16, 1985, in accordance with the Public Utilities Regulatory Policies Act of 1978,

then the person referred to in paragraph (2) shall not be treated as the principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the Internal Revenue Code of 1954.

(g) TREATMENT OF CERTAIN OBLIGATIONS TO FINANCE HYDROELECTRIC GENERATING FACILITIES.—If—

(1) obligations are to be issued in an amount not to exceed $6,000,000 to finance the construction of a hydroelectric generat-

ing facility having a Federal Energy Regulatory Commission license number 3189, and located near Placerville, California,

(2) an inducement resolution for such project was adopted in March 1985, and

(3) substantially all of the electrical power generated by such facility is to be sold to a nongovernmental person pursuant to a long-term power sales agreement in accordance with the Public Utilities Regulatory Policies Act of 1978,

then the person referred to in paragraph (3) shall not be treated as the principal user of such facilities by reason of such sales for purposes of subparagraphs (D) and (E) of section 103(b)(6) of the Internal Revenue Code of 1954.

CHAPTER 7—MISCELLANEOUS PROVISIONS

SEC. 1875. AMENDMENTS RELATED TO TITLE VII OF THE ACT.

(a) AMENDMENT RELATED TO SECTION 711(a).—Subsection (c) of section 58 (relating to estates and trusts) is amended by striking out "of tax preference" and inserting in lieu thereof "of tax preference (and any itemized deductions)".

(b) AMENDMENT RELATED TO SECTION 712(1).—Paragraph (1) of section 304(a) (relating to treatment of certain stock purchases) is amended by striking out "In any such case" and inserting in lieu thereof "To the extent that such distribution is treated as a distribution to which section 301 applies".

(c) AMENDMENTS RELATED TO SECTION 713.—

(1)(A) Section 402(a)(5)(F)(ii) (relating to special rules for key employees) is amended to read as follows:

"(ii) 5-PERCENT OWNERS.—An eligible retirement plan described in subclause (III) or (IV) of subparagraph (E)(iv) shall not be treated as an eligible retirement plan for the transfer of a distribution if the employee is a 5-percent owner at the time such distribution is made. For purposes of the preceding sentence, the term '5-percent owner' means any individual who is a 5-percent owner (as defined in section 416(i)(1)(B)) at any time during the 5 plan years preceding the plan year in which the distribution is made."

(B) The amendments made by subparagraph (A) shall apply to distributions after the date of the enactment of this Act. Such amendments shall apply also to distributions after 1983 and on or before the date of the enactment of this Act to individuals who are not 5-percent owners (as defined in section 402(a)(5)(F)(ii) of the Internal Revenue Code of 1954 (as amended by this paragraph)).

(2) Section 713(c) of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraph:

"(4) EFFECTIVE DATE FOR PARAGRAPH (3).—The amendment made by paragraph (3) shall apply to distributions after July 18, 1984."

(3) Section 62(7) (relating to pension, profit-sharing, and annuity plans of self-employed individuals) is amended by striking out "to the extent attributable to contributions made on behalf of such individual".

(4) Section 219(f)(1) (defining compensation) is amended by striking out "reduced by any amount allowable as a deduction to the individual in computing adjusted gross income under paragraph (7) of section 62".

(5) Section 713(d)(1) of the Tax Reform Act of 1984 is amended by striking out "Paragraph" and inserting in lieu thereof "Effective with respect to contributions made in taxable years beginning after December 31, 1983, paragraph".

(6)(A) Section 408(d)(5) (relating to certain distributions of excess contributions after due date) is amended by striking out "$15,000" and inserting in lieu thereof "the dollar limitation in effect under section 415(c)(1)(A) for such taxable year".

(B) Subparagraph (C) of section 219(b)(2) is amended by striking out "the $15,000 amount specified in subparagraph (A)(ii)" and inserting in lieu thereof "the dollar limitation in effect under section 415(c)(1)(A)".

(7)(A) Subparagraph (C) of section 404(a)(8) is amended by striking out "the earned income of such individual" and inserting in lieu thereof "the earned income of such individual (determined without regard to the deductions allowed by this section)".

(B) Effective with respect to taxable years beginning after December 31, 1984, subparagraph (D) of section 404(a)(8) is amended by striking out "(determined without regard to the deductions allowed by this section and section 405(c))".

(8) Subparagraph (A) of section 408(d)(3) is amended—

(A) by striking out "(other than a trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan)" in clause (ii),

(B) by striking out "(other than a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan)" in clause (ii), and

(C) by adding at the end thereof the following new sentence:

"Clause (ii) shall not apply during the 5-year period beginning on the date of the qualified total distribution referred to in such clause if the individual was treated as a 5-percent owner with respect to such distribution under section 402(a)(5)(F)(ii)."

(9) Clause (iii) of section 415(b)(2)(E) is amended by striking out "adjusting any benefit or limitation under subparagraph (B), (C), or (D)" and inserting in lieu thereof "this subsection".

(10) Subparagraph (B) of section 3405(d)(1) is amended by striking out "or" at the end of clause (ii), and by striking out the material following clause (ii) and inserting in lieu thereof the following:

"(iii) any amount which is subject to withholding under subchapter A of chapter 3 (relating to withholding of tax on nonresident aliens and foreign corporations) by the person paying such amount or which would be so subject but for a tax treaty, or

"(iv) any distribution described in section 404(k)(2)."

(11) Subparagraph (C) of section 415(c)(3) is amended by striking out "a profit-sharing or stock bonus plan" and inserting in lieu thereof "any defined contribution plan".

(12) The amendments made by paragraphs (3), (4), and (6) shall take effect as if included in the amendments made by section 238 of the Tax Equity and Fiscal Responsibility Act of 1982.

(d) Amendments Relating to Section 714 of the Act.—

(1) Period of limitations.—Section 6229 is amended by adding at the end thereof the following new subsection:

"(g) Period of Limitations for Penalties.—The provisions of this section shall apply also in the case of any addition to tax or an additional amount imposed under subchapter A of chapter 68 which arises with respect to any tax imposed under subtitle A in the same manner as if such addition or additional amount were a tax imposed by subtitle A."

(2) Coordination with deficiency proceedings.—

(A) In general.—Subsection (a) of section 6230 is amended to read as follows:

"(a) Coordination With Deficiency Proceedings.—

"(1) In general.—Except as provided in paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

"(2) Deficiency proceedings to apply in certain cases.—

"(A) Subchapter B shall apply to any deficiency attributable to—

"(i) affected items which require partner level determinations, or

"(ii) items which have become nonpartnership items and are described in section 6231(e)(1)(B).

"(B) Subchapter B shall be applied separately with respect to each deficiency described in subparagraph (A) attributable to each partnership.

"(C) Notwithstanding any other law or rule of law, any notice or proceeding under subchapter B with respect to a deficiency described in this paragraph shall not preclude or be precluded by any other notice, proceeding, or determination with respect to a partner's tax liability for a taxable year."

(B) Technical amendments.—

(i) Paragraph (4) of section 6213(h) is amended to read as follows:

"(4) For provisions relating to application of this subchapter in the case of certain partnership items, etc., see section 6230(a)."

(ii) Paragraph (1) of section 6503(a) is amended by striking out "section 6501 or 6502" and inserting in lieu thereof "section 6501 or 6502 (or section 6229, but only with respect to a deficiency described in section 6230(a)(2)(A))."

(C) Effective date.—The amendments made by this paragraph shall take effect as if included in the Tax Equity and Fiscal Responsibility Act of 1982.

(3) EFFECTIVE DATE PROVISION.—Notwithstanding section 715 of the Tax Reform Act of 1984, the amendments made by section 714(n)(2) of such Act shall apply only to applications filed after July 18, 1984.

(3) ESTATE AND TRUST INTERESTS HELD BY NOMINEES.—

(A) IN GENERAL.—Section 6034A is amended—

(i) by striking out "The fiduciary" and inserting in lieu thereof "(a) GENERAL RULE.—The fiduciary",

(ii) by striking out "each beneficiary" and inserting in lieu thereof "each beneficiary (or nominee thereof)", and

(iii) by adding at the end thereof the following new subsection:

"(b) NOMINEE REPORTING.—Any person who holds an interest in an estate or trust as a nominee for another person—

"(1) shall furnish to the estate or trust, in the manner prescribed by the Secretary, the name and address of such other person, and any other information for the taxable year as the Secretary may by form and regulations prescribe, and

"(2) shall furnish in the manner prescribed by the Secretary to such other person the information provided by the estate or trust under subsection (a)."

(B) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to taxable years of estates and trusts beginning after the date of the enactment of this Act.

(e) AMENDMENT RELATED TO SECTION 734 OF THE ACT.—Subsection (a) of section 201 of the Land and Water Conservation Fund Act of 1965 (16 U.S.C. 460l–11) is amended by striking out "section 209(f)(5) of the Highway Revenue Act of 1956" and inserting in lieu thereof "section 9503(c)(4)(B) of the Internal Revenue Code of 1954".

(f) AMENDMENT RELATED TO SECTION 735 OF THE ACT.—The table of sections for part I of subchapter A of chapter 32 is amended by striking out "guzzlers" and inserting in lieu thereof "guzzler".

(g) AMENDMENT OF SECTION 1248.—

(1) IN GENERAL.—Subsection (g) of section 1248 (relating to exceptions) is amended by inserting "or" at the end of paragraph (1), by striking out paragraph (2), and by redesignating paragraph (3) as paragraph (2).

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to exchanges after March 1, 1986.

(3) TRANSITIONAL RULE.—An exchange shall be treated as occurring on or before March 1, 1986, if—

(A) on or before such date, the taxpayer adopts a plan of reorganization to which section 356 applies, and

(B) such plan or reorganization is implemented and distributions pursuant to such plan are completed on or before the date of enactment of this Act.

SEC. 1876. AMENDMENTS RELATED TO TITLE VIII OF THE ACT.

(a) TREATMENT OF SECTION 923(a)(2) NON-EXEMPT INCOME.—

(1) Paragraph (6) of section 927(d) (defining section 923(a)(2) non-exempt income) is amended by adding at the end thereof the following new sentence: "Such term shall not include any income which is effectively connected with the conduct of a

trade or business within the United States (determined without regard to this subpart).”

(2) Paragraph (6) of section 1248(d) (relating to foreign trade income) is amended to read as follows:

“(6) FOREIGN TRADE INCOME.—Earnings and profits of the foreign corporation attributable to foreign trade income of a FSC other than foreign trade income which—

“(A) is section 923(a)(2) non-exempt income (within the meaning of section 927(d)(6)), or

“(B) would not (but for section 923(a)(4)) be treated as exempt foreign trade income.

For purposes of the preceding sentence, the terms ‘foreign trade income’ and ‘exempt foreign trade income’ have the respective meanings given such terms by section 923.”

(b) CLARIFICATION OF PREFERENCE CUTBACKS.—

(1) Paragraph (4) of section 291(a) (relating to 20-percent reduction in certain preference items, etc.) is amended to read as follows:

“(4) CERTAIN FSC INCOME.—In the case of taxable years beginning after December 31, 1984, section 923(a) shall be applied with respect to any FSC by substituting—

“(A) ‘30 percent’ for ‘32 percent’ in paragraph (2), and

“(B) ‘$^{15}/_{23}$’ for ‘$^{16}/_{23}$’ in paragraph (3).

If all of the stock in the FSC is not held by 1 or more C corporations throughout the taxable year, under regulations, proper adjustments shall be made in the application of the preceding sentence to take into account stock held by persons other than C corporations.”

(2) Subparagraph (F) of section 995(b)(1) (relating to deemed distributions from a DISC) is amended—

(A) by inserting “in the case of a shareholder which is a C corporation,” before “one-seventeenth” in clause (i), and

(B) by striking out “the amount determined under clause (i)” in clause (ii) and inserting in lieu thereof “$^{16}/_{17}$ of the excess referred to in clause (i),”.

(3) Subsection (a) of section 923 (defining exempt foreign trade income) is amended by adding at the end thereof the following new paragraph:

“(6) CROSS REFERENCE.—

“For reduction in amount of exempt foreign trade income, see section 291(a)(4).”

(c) TREATMENT OF FOREIGN TRADE INCOME UNDER SUBPART F.—

(1) Subsection (b) of section 952 (relating to exclusion of United States income) is amended by adding at the end thereof the following new sentence: “For purposes of the preceding sentence, income described in paragraph (2) or (3) of section 921(d) shall be treated as derived from sources within the United States.”

(2) Paragraph (1) of section 951(e) is amended by striking out the last sentence.

(d) DIVIDENDS RECEIVED DEDUCTION FOR CERTAIN DISTRIBUTIONS FROM A FSC.—

(1) DEDUCTION FOR CERTAIN DIVIDENDS.—

(A) Paragraph (1) of section 245(c) (relating to certain dividends received from FSC) is amended to read as follows:

"(1) IN GENERAL.—In the case of a domestic corporation, there shall be allowed as a deduction an amount equal to—

"(A) 100 percent of any dividend received by such corporation from another corporation which is distributed out of earnings and profits attributable to foreign trade income for a period during which such other corporation was a FSC, and

"(B) 85 percent of any dividend received by such corporation from another corporation which is distributed out of earnings and profits attributable to qualified interest and carrying charges received or accrued by such other corporation while such other corporation was a FSC.

The deduction allowable under the preceding sentence with respect to any dividend shall be in lieu of any deduction allowable under subsection (a) or (b) with respect to such dividend."

(B) Paragraph (3) of section 245(c) (relating to definitions) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection, the term 'qualified interest and carrying charges' means any interest or carrying charges (as defined in section 927(d)(1)) derived from a transaction which results in foreign trade income."

(2) SEPARATE APPLICATION OF SECTION 904.—Subparagraph (D) of section 904(d)(1) is amended to read as follows:

"(D) distributions from a FSC (or a former FSC) out of earnings and profits attributable to foreign trade income (within the meaning of section 923(b)) or qualified interest and carrying charges (as defined in section 245(c)), and".

(3) COORDINATION OF SECTIONS 906 AND 902.—Subsection (b) of section 906 (relating to nonresident alien individuals and foreign corporations) is amended by adding at the end thereof the following new paragraph:

"(6) For purposes of section 902, any income, war profits, and excess profits taxes paid or accrued (or deemed paid or accrued) to any foreign country or possession of the United States with respect to income effectively connected with the conduct of a trade or business within the United States shall not be taken into account, and any accumulated profits attributable to such income shall not be taken into account."

(e) EXCHANGE OF INFORMATION REQUIREMENTS.—

(1) Paragraph (3) of section 927(e) (relating to exchange of information requirements) is amended—

(A) by striking out "unless, at the same time such corporation was created or organized, there was" and inserting in lieu thereof "unless there is",

(B) by striking out "section 274(h)(6)(C)" in subparagraph (A) and inserting in lieu thereof "section 274(h)(6)(C) (determined by treating any reference to a beneficiary country as being a reference to any foreign country and by applying such section without regard to clause (ii) thereof)", and

(C) by amending subparagraph (B) to read as follows:

"(B) an income tax treaty which contains an exchange of information program—

"(i) which the Secretary certifies (and has not revoked such certification) is satisfactory in practice for purposes of this title, and

"(ii) to which the FSC is subject."

(2) Effective for periods after March 28, 1985, paragraph (2) of section 924(c) (relating to requirement that FSC be managed outside the United States) is amended to read as follows:

"(2) the principal bank account of the corporation is maintained in a foreign country which meets the requirements of section 927(e)(3) or in a possession of the United States at all times during the taxable year, and".

(f) Coordination With Possessions Taxation.—

(1) Paragraph (5) of section 927(e) (relating to exemption from certain other taxes) is amended to read as follows:

"(5) Coordination with possessions taxation.—

"(A) Exemption.—No tax shall be imposed by any possession of the United States on any foreign trade income derived before January 1, 1987. The preceding sentence shall not apply to any income attributable to the sale of property or the performance of services for ultimate use, consumption, or disposition within the possession.

"(B) Clarification that possession may exempt certain income from tax.—Nothing in any provision of law shall be construed as prohibiting any possession of the United States from exempting from tax any foreign trade income of a FSC or any other income of a FSC described in paragraph (2) or (3) of section 921(d).

"(C) No cover over of taxes imposed on FSC.—Nothing in any provision of law shall be construed as requiring any tax imposed by this title on a FSC to be covered over (or otherwise transferred) to any possession of the United States."

(2) Clerical amendment.—Section 934 is amended by striking out the subsection (f) added by section 801(d)(7) of the Tax Reform Act of 1984.

(g) Clarification of Interest on DISC-Related Deferred Tax Liability.—Subsection (f) of section 995 (relating to interest on DISC-related deferred tax liability) is amended by adding at the end thereof the following new paragraph:

"(7) DISC includes former DISC.—For purposes of this subsection, the term 'DISC' includes a former DISC."

(h) Clarification of Exemption of Accumulated DISC Income.—Subparagraph (A) of section 805(b)(2) of the Tax Reform Act of 1984 (relating to exemption of accumulated DISC income from tax) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, the term 'actual distribution' includes a distribution in liquidation, and the earnings and profits of any corporation receiving a distribution not included in gross income by reason of the preceding sentence shall be increased by the amount of such distribution."

(i) Clarification of Effective Date for Requirement That Taxable Year of DISC and FSC Conform to Taxable Year of

Majority Shareholder.—Paragraph (4) of section 805(a) of the Tax Reform Act of 1984 is amended to read as follows:

"(4) Section 803.—The amendments made by section 803 shall apply to taxable years beginning after December 31, 1984."

(j) Application of Dividends Received Deduction With Respect to Certain Dividends.—Subsection (c) of section 245 (relating to dividends received from certain foreign corporations) is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) Coordination with subsections (a) and (b).—The gross income giving rise to the earnings and profits described in subparagraph (A) or (B) of paragraph (1) (and not described in paragraph (2)) shall not be taken into account under subsections (a) and (b)."

(k) Treatment of Certain Qualifying Distributions From DISC.—Paragraph (2) of section 996(a) (relating to qualifying distributions) is amended by striking out the last sentence and inserting in lieu thereof the following: "In the case of any amount of any actual distribution to a C corporation made pursuant to section 992(c) which is required to satisfy the condition of section 992(a)(1)(A), the preceding sentence shall apply to 16/17ths of such amount and paragraph (1) shall apply to the remaining 1/17th of such amount."

(l) Treatment of Certain Receipts From Other FSC.—Paragraph (1) of section 924(f) (relating to certain receipts not included in foreign trade gross receipts) is amended by adding at the end thereof the following new sentence:

"In the case of gross receipts of a FSC from a transaction involving any property, subparagraph (C) shall not apply if such FSC (and all other FSC's which are members of the same controlled group and which receive gross receipts from a transaction involving such property) do not use the pricing rules under paragraph (1) of section 925(a) (or the corresponding provisions of the regulations prescribed under section 925(b)) with respect to any transaction involving such property."

(m) Treatment of Certain Former Export Trade Corporations.—If—

(1) a corporation which is not an export trading corporation for its most recent taxable year ending before the date of the enactment of the Tax Reform Act of 1984 but was an export trading corporation for any prior taxable year, and

(2)(A) such corporation may not qualify as an export trade corporation for any taxable year beginning after December 31, 1984, by reason of section 971(a)(3) of the Internal Revenue Code of 1954, or (B) such corporation makes an election, before the date 6 months after the date of the enactment of this Act, not to be treated as an export trade corporation with respect to taxable years beginning after December 31, 1984,

rules similar to the rules of paragraphs (2) and (4) of section 805(b) of the Tax Reform Act of 1984 shall apply to such corporation. For purposes of the preceding sentence, the term "export trade corporation" has the meaning given such term by section 971 of such Code.

(n) Treatment of Distribution of Accumulated DISC Income Received by Cooperatives.—Paragraph (2) of section 805(b) of the

Tax Reform Act of 1984 (relating to transition rules for DISC's) is amended by adding at the end thereof the following new subparagraph:

"(C) TREATMENT OF DISTRIBUTION OF ACCUMULATED DISC INCOME RECEIVED BY COOPERATIVES.—In the case of any actual distribution received by an organization described in section 1381 of such Code and excluded from the gross income of such corporation by reason of subparagraph (A)—

"(i) such amount shall not be included in the gross income of any member of such organization when distributed in the form of a patronage dividend or otherwise, and

"(ii) no deduction shall be allowed to such organization by reason of any such distribution."

(o) TREATMENT OF CERTAIN CONTRACTS.—Paragraph (2) of section 805(a) of the Tax Reform Act of 1984 (relating to transitional rule for certain contracts) is amended to read as follows:

"(2) SPECIAL RULE FOR CERTAIN CONTRACTS.—To the extent provided in regulations prescribed by the Secretary of the Treasury or his delegate, any event or activity required to occur or required to be performed, before January 1, 1985, by section 924 (c) or (d) or 925(c) of the Internal Revenue Code of 1954 shall be treated as meeting the requirements of such section if such event or activity is with respect to—

"(A) any lease of more than 3 years duration which was entered into before January 1, 1985,

"(B) any contract with respect to which the taxpayer uses the completed contract method of accounting which was entered into before January 1, 1985, or

"(C) in the case of any contract other than a lease or contract described in subparagraph (A) or (B), any contract which was entered into before January 1, 1985; except that this subparagraph shall only apply to the first 3 taxable years of the FSC ending after January 1, 1985, or such later taxable years as the Secretary of the Treasury or his delegate may prescribe."

(p) CLERICAL AMENDMENTS.—

(1) Subsection (f) of section 995 is amended by redesignating the paragraphs following the paragraph (3) relating to deferred DISC income as paragraphs (4), (5), and (6).

(2) Subsection (h) of section 901 is amended by striking out "section 927(d)(6)" and inserting in lieu thereof "section 927(d)(6))".

(3) Paragraph (3) of section 802(c) of the Tax Reform Act of 1984 is hereby repealed.

(4) Subparagraph (A) of section 805(a)(2) of the Tax Reform Act of 1984 is amended by striking out "the taxpayer" and inserting in lieu thereof "the DISC or a related party".

(5) Paragraph (2) of section 927(e) is amended by striking out "clauses (i) and (ii)" and inserting in lieu thereof "clauses (ii) and (iii)".

SEC. 1877. AMENDMENTS RELATED TO TITLE IX OF THE ACT.

(a) Amendment Related to Section 911 of the Act.—Paragraph (3) of section 34(a) (relating to credit for certain uses of gasoline and special fuels) is amended to read as follows:

"(3) under section 6427—

"(A) with respect to fuels used for nontaxable purposes or resold, or

"(B) with respect to any qualified diesel-powered highway vehicle purchased (or deemed purchased under section 6427(g)(6)),

during the taxable year (determined without regard to section 6427(j))."

(b) Amendments Related to Section 915 of the Act.—

(1) Paragraph (2) of section 6427(b) (relating to intercity, local, or school buses) is amended by redesignating subparagraphs (B) and (C) as subparagraphs (C) and (D), respectively, and by inserting after subparagraph (A) the following new subparagraph:

"(B) Exception for school bus transportation.—Subparagraph (A) shall not apply to fuel used in an automobile bus while engaged in the transportation described in paragraph (1)(B)."

(2) Subparagraph (A) of section 6427(b)(2) is amended by striking out "subparagraph (B)" and inserting in lieu thereof "subparagraphs (B) and (C)".

(3) The heading for subparagraph (C) of section 6427(b)(2), as redesignated by paragraph (1), is amended by striking out "Exception" and inserting in lieu thereof "Exception for certain intracity transportation".

(c) Amendment Related to Section 921 of the Act.—Paragraph (3) of section 4051(d) (relating to temporary reduction in tax on certain piggyback trailers) is amended by adding at the end thereof the following new sentence:

"No tax shall be imposed by reason of this paragraph on any use or resale which occurs more than 6 years after the date of the first retail sale."

SEC. 1878. AMENDMENTS RELATED TO TITLE X OF THE ACT.

(a) Amendment Related to Section 1001 of the Act.—Subsection (b) of section 1001 of the Tax Reform Act of 1984 is amended by adding at the end thereof the following new paragraph:

"(24) Clause (i) of section 1278(a)(1)(B) (relating to short-term obligations)."

(b) Amendment Related to Section 1015 of the Act.—Subparagraph (I) of section 4162(a)(6) (defining sport fishing equipment) is amended to read as follows:

"(I) fishing hook disgorgers, and".

(c) Amendments Related to Section 1018 of the Act.—

(1) Paragraph (1) of section 4041(l) (relating to exemption for certain helicopter uses) is amended to read as follows:

"(1) transporting individuals, equipment, or supplies in the exploration for, or the development or removal of, hard minerals, oil, or gas, or".

(2) Paragraph (1) of section 4261(e) (relating to exemption for certain helicopter uses) is amended to read as follows:

"(1) transporting individuals, equipment, or supplies in the exploration for, or the development or removal of, hard minerals, oil, or gas, or".

(d) Amendments Related to Section 1028 of the Act.—Subsection (b) of section 1028 of the Tax Reform Act of 1984 (relating to credit against estate tax for transfers to Toiyabe National Forest) is amended to read as follows:

"(b) Amount of Credit.—

"(1) In general.—The amount allowed as a credit under subsection (a) shall be equal to the lesser of—

"(A) the fair market value of the real property transferred by each estate as of the valuation date used for purposes of the tax imposed by chapter 11 of such Code, or

"(B) the Federal estate tax liability (and interest thereon) of each estate.

"(2) Special rule for Rabe estate.—In the case of the estate described in paragraph (2) of subsection (a), the amount allowed as a credit under subsection (a) shall be equal to the Federal estate tax liability (and interest accruing thereon through the date of a transfer described in paragraph (1) of subsection (c)) of such estate."

(e) Amendments Related to Section 1034 of the Act.—

(1) The last sentence of section 514(c)(9)(B) (relating to exceptions) is amended by striking out "would be unrelated business taxable income (determined without regard to this paragraph)" and inserting in lieu thereof "is unrelated business taxable income".

(2) Clause (i) of section 514(c)(9)(C) is amended by striking out "section 509(a)" and inserting in lieu thereof "section 509(a)(3)".

(3) Clause (vi) of section 514(c)(9)(B) is amended to read as follows:

"(vi) the real property is held by a partnership (which does not fail to meet the requirements of clauses (i) through (v)), and—

"(I) any partner of the partnership is not a qualified organization, and

"(II) the principal purpose of any allocation to any partner of the partnership which is a qualified organization which is not a qualified allocation (within the meaning of section 168(j)(9)) is the avoidance of income tax.

For purposes of subclause (I) of clause (vi), an organization shall not be treated as a qualified organization if any income of such organization would be unrelated business taxable income (determined without regard to this paragraph. For purposes of clause (vi), an interest in a mortgage shall in no event be treated as real property."

(f) Amendments Related to Section 1041 of the Act.—

(1) The subsection (j) of section 51 (relating to targeted jobs credit) added by section 1041 of the Tax Reform Act of 1984 is hereby redesignated as subsection (k).

(2) Subparagraph (B) of section 1041(c)(5) of the Tax Reform Act of 1984 is amended by striking out "section 51(j)" and inserting in lieu thereof "section 51(k)".

(g) Amendment Related to Section 1053 of the Act.—Paragraph (2) of section 1034(h) (relating to members of armed forces) is amended by striking out "before the last day described" and inserting in lieu thereof "before the day which is 1 year after the last day described".

(h) Amendment Related to Section 1063 of the Act.—Subsection (c) of section 1063 of the Tax Reform Act of 1984 (relating to permanent disallowance of deduction for expenses of demolition of certain structures) is amended to read as follows:

"(c) Effective Dates.—

"(1) The amendments made by this section shall apply to taxable years ending after December 31, 1983, but shall not apply to any demolition (other than of a certified historic structure) commencing before July 19, 1984.

"(2) For purposes of paragraph (1), if a demolition is delayed until the completion of the replacement structure on the same site, the demolition shall be treated as commencing when construction of the replacement structure commences.

"(3) The amendments made by this section shall not apply to any demolition commencing before September 1, 1984, pursuant to a bank headquarters building project if—

"(A) on April 1, 1984, a corporation was retained to advise the bank on the final completion of the project, and

"(B) on June 12, 1984, the Comptroller of the Currency approved the project.

"(4) The amendments made by this section shall not apply to the remaining adjusted basis at the time of demolition of any structure if—

"(A) such structure was used in the manufacture, storage, or distribution of lead alkyl antiknock products and intermediate and related products at facilities located in or near Baton Rouge, Louisiana, and Houston, Texas, owned by the same corporation, and

"(B) demolition of at least one such structure at the Baton Rouge facility commenced before January 1, 1984."

(i) Amendment Related to Section 1065 of the Act.—Subsection (b) of section 1065 of the Tax Reform Act of 1984 (relating to rules treating Indian tribal governments as States) is amended by striking out "section 7871" and inserting in lieu thereof "section 7871(a)".

(j) Amendments Related to Section 1071 of the Act.—

(1) Subsection (a) of section 852 (relating to taxation of regulated investment companies and their shareholders) is amended by adding "and" at the end of paragraph (1), by striking out paragraph (2), and by redesignating paragraph (3) as paragraph (2).

(2) Paragraph (1) of section 852(b) (relating to imposition of tax on regulated investment companies) is amended by striking out the last sentence and inserting in lieu thereof the following: "In the case of a regulated investment company which is a personal holding company (as defined in section 542) or which fails to comply for the taxable year with regulations prescribed by the Secretary for the purpose of ascertaining the actual own-

ership of its stock, such tax shall be computed at the highest rate of tax specified in section 11(b)."

SEC. 1879. MISCELLANEOUS PROVISIONS.

(a) WAIVER OF ESTIMATED TAX PENALTIES.—No addition to tax shall be made under section 6654 or 6655 of the Internal Revenue Code of 1954 (relating to failure to pay estimated income tax) for any period before April 16, 1985 (March 16, 1985 in the case of a taxpayer subject to section 6655 of such Code), with respect to any underpayment, to the extent that such underpayment was created or increased by any provision of the Tax Reform Act of 1984.

(b) AMENDMENTS RELATED TO ORPHAN DRUG CREDIT.—

(1) Clause (ii) of section 28(b)(2)(A) (defining clinical testing) is amended—

(A) by striking out "the date of such drug" in subclause (I) and inserting in lieu thereof "the date such drug", and

(B) by striking out "of such Act" in subclause (II) and inserting in lieu thereof "of such Act or, if the drug is a biological product, before the date on which a license for such drug is issued under section 351 of the Public Health Services Act".

(2) Paragraph (1) of section 28(d) (defining rare disease or condition) is amended to read as follows:

"(1) RARE DISEASE OR CONDITION.—For purposes of this section, the term 'rare disease or condition' means any disease or condition which—

"(A) affects less than 200,000 persons in the United States, or

"(B) affects more than 200,000 persons in the United States but for which there is no reasonable expectation that the cost of developing and making available in the United States a drug for such disease or condition will be recovered from sales in the United States of such drug.

Determinations under the preceding sentence with respect to any drug shall be made on the basis of the facts and circumstances as of the date such drug is designated under section 526 of the Federal Food, Drug, and Cosmetic Act."

(3) The amendments made by this subsection shall apply to amounts paid or incurred after December 31, 1982, in taxable years ending after such date.

(c) TREATMENT OF SALES WITHIN AFFILIATED GROUP FOR PURPOSES OF SECTION 29.—

(1) Paragraph (8) of section 29(d) (relating to related persons) is amended by adding at the end thereof the following new sentence: "In the case of a corporation which is a member of an affiliated group of corporations filing a consolidated return, such corporation shall be treated as selling qualified fuels to an unrelated person if such fuels are sold to such a person by another member of such group."

(2) The amendment made by paragraph (1) shall take effect as if included in the amendments made by section 231 of Public Law 96-223.

(d) RETURNS AND RECORDS WITH RESPECT TO CERTAIN FRINGE BENEFITS.—

(1) Subsection (d) of section 6039D (added by section 1 of Public Law 98-611) is amended to read as follows:

"(d) Definitions.—For purposes of this section—

"(1) Specified fringe benefit plan.—The term 'specified fringe benefit plan' means—

"(A) any qualified group legal services plan (as defined in section 120),

"(B) any cafeteria plan (as defined in section 125), and

"(C) any educational assistance plan (as defined in section 127).

"(2) Applicable exclusion.—The term 'applicable exclusion' means—

"(A) section 120 in the case of a qualified group legal services plan,

"(B) section 125 in the case of a cafeteria plan, and

"(C) section 127 in the case of an educational assistance plan."

(2) The section 6039D added by section 1 of Public Law 98-612 is hereby repealed.

(e) Repeal of Joint Committee Report Requirement.—Section 6405 (relating to reports of refunds and credits) is amended by striking out subsection (b) and redesignating subsections (c), (d), and (e) as subsections (b), (c), and (d), respectively.

(f) Amendments Related to Public Law 99-121.—

(1) The table contained in section 467(e)(3)(A) is amended—

(A) by striking out "18-year real property" and inserting in lieu thereof "19-year real property", and

(B) by striking out "18 years" and inserting in lieu thereof "19 years".

(2) The amendments made by paragraph (1) shall take effect as if included in the amendments made by section 103 of Public Law 99-121.

(g) Defined Contribution Plan of Rural Electric Cooperative May Include Qualified Cash or Deferred Arrangement.—

(1) In general.—Paragraphs (1) and (2) of section 401(k) (relating to cash or deferred arrangements) are each amended by striking out "(or a pre-ERISA money purchase plan)" and inserting in lieu thereof ", a pre-ERISA money purchase plan, or a rural electric cooperative plan".

(2) Rural electric cooperative plan defined.—Subsection (k) of section 401 is amended by adding at the end thereof the following new paragraph:

"(6) Rural electric cooperative plan.—For purposes of this subsection, the term 'rural electric cooperative plan' means any pension plan—

"(A) which is a defined contribution plan (as defined in section 414(i)), and

"(B) which is established and maintained by a rural electric cooperative (as defined in section 457(d)(9)(B)) or a national association of such rural electric cooperatives."

(3) Effective date.—The amendments made by this subsection shall apply to plan years beginning after December 31, 1984.

(h) Clarification of Definition of Newly Discovered Oil.—

(1) IN GENERAL.—Paragraph (2) of section 4991(e) (defining newly discovered oil) is amended by adding at the end thereof the following new sentences: "Such term includes any production from a property which did not produce oil in commercial quantities during calendar year 1978. For purposes of the preceding sentence, a property shall not be treated as producing oil in commercial quantities during calendar year 1978 if, during calendar year 1978 (A) the aggregate amount of oil produced from such property did not exceed 2,200 barrels (whether or not such oil was sold), and (B) no well on such property was in production for a total of more than 72 hours."

(2) EFFECTIVE DATE.—The amendments made by paragraph (1) shall apply to oil removed after February 29, 1980.

(i) MEDICINAL ALCOHOL, ETC. BROUGHT INTO THE UNITED STATES FROM PUERTO RICO OR THE VIRGIN ISLANDS ELIGIBLE FOR DRAWBACK.—

(1) Section 7652 (relating to shipments to the United States) is amended by adding at the end thereof the following new subsection:

"(g) DRAWBACK FOR MEDICINAL ALCOHOL, ETC.—In the case of medicines, medicinal preparations, food products, flavors, or flavoring extracts containing distilled spirits, which are unfit for beverage purposes and which are brought into the United States from Puerto Rico or the Virgin Islands—

"(1) subpart F of part II of subchapter A of chapter 51 shall be applied as if—

"(A) the use and tax determination described in section 5131(a) had occurred in the United States by a United States person at the time the article is brought into the United States, and

"(B) the rate of tax were the rate applicable under subsection (f) of this section, and

"(2) no amount shall be covered into the treasuries of Puerto Rico or the Virgin Islands."

(2) The amendment made by paragraph (1) shall apply to articles brought into the United States after the date of the enactment of this Act.

(3)(A) Section 7652 of the Internal Revenue Code of 1954 (other than subsection (f) thereof) shall not prevent the payment to Puerto Rico or the Virgin Islands of amounts with respect to medicines, medicinal preparations, food products, flavors, or flavoring extracts containing distilled spirits, which are unfit for beverage purposes and which are brought into the United States from Puerto Rico or the Virgin Islands on or before the date of the enactment of this Act.

(B) With respect to articles brought into the United States after September 27, 1985, subparagraph (A) shall apply only if the Secretary of the Treasury or his delegate is satisfied that the amounts paid to Puerto Rico or the Virgin Islands under subparagraph (A) are being repaid to the proper persons who used the distilled spirits in such articles.

(j) ALLOWANCE OF INVESTMENT CREDIT TO ELIGIBLE SECTION 501(d) ORGANIZATIONS.—

(1) In general.—Section 48 (relating to definitions and special rules) is amended by redesignating subsection (r) as subsection (s) and by inserting after subsection (q) the following new subsection:

"(r) Certain Section 501(d) Organizations.—

"(1) In general.—In the case of eligible section 501(d) organizations—

"(A) any business engaged in by such organization for the common benefit of its members and the taxable income from which is included in the gross income of its members shall be treated as an unrelated business for purposes of paragraph (4) of subsection (a),

"(B) the qualified investment for each taxable year with respect to such business shall be apportioned pro rata among such members in the same manner as the taxable income of such organization, and

"(C) any individual to whom any investment has been apportioned under subparagraph (B) shall be treated for purposes of this subpart (other than section 47) as the taxpayer with respect to such investment, and such investment shall not (by reason of such apportionment) lose its character as an investment in new section 38 property or used section 38 property, as the case may be.

"(2) Limitation on used section 38 property applied at organization level.—The limitation under subparagraph (A) of subsection (c)(2) shall apply with respect to the section 501(d) organization.

"(3) Recapture.—For purposes of applying section 47 to any property for which credit was allowed under section 38 by reason of this subsection—

"(A) the section 501(d) organization shall be treated as the taxpayer to which the credit under section 38 was allowed,

"(B) the amount of such credit allowed with respect to the property shall be treated as the amount which would have been allowed to the section 501(d) organization were such credit allowable to such organization,

"(C) subparagraph (D) of section 47(a)(5) shall not apply, and

"(D) the amount of the increase in tax under section 47 for any taxable year with respect to property to which this subsection applies shall be allocated pro rata among the members of such organization in the same manner as such organization's taxable income for such year is allocated among such members.

"(4) No investment credit allowed to member if member claims other investment credit.—No credit shall be allowed to an individual by reason of this subsection if such individual claims a credit under section 38 without regard to this subsection. The amount of the credit not allowed by reason of the preceding sentence shall not be allowed to any other person.

"(5) Eligible section 501(d) organization.—For purposes of this subsection, the term 'eligible section 501(d) organization' means any organization—

"(A) which elects to be treated as an organization described in section 501(d) and which is exempt from tax under section 501(a), and

"(B) which does not provide a substantially higher standard of living for any person or persons than it does for the majority of the members of the community."

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to periods after December 31, 1978 (under rules similar to the rules of section 48(m) of the Internal Revenue Code of 1954), in taxable years ending after such date.

(3) SPECIAL RULE.—If refund or credit of any overpayment of tax resulting from the application of this subsection is prevented at any time before the close of the date which is 1 year after the date of the enactment of this Act by operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable to the application of the amendments made by this subsection) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 1-year period.

(k) AMENDMENT RELATED TO MUTUAL SAVINGS BANKS DESCRIBED IN SECTION 591(b).—

(1) IN GENERAL.—Subparagraph (B) of section 501(c)(14) (relating to list of tax-exempt organizations) is amended—

(A) by striking out "or" at the end of clause (ii),

(B) by striking out the period at the end of clause (iii) and inserting in lieu thereof a comma and "or", and

(C) by inserting at the end thereof the following new clause:

"(iv) mutual savings banks described in section 591(b)".

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years ending after August 13, 1981.

(l) AMENDMENT TO SECTION 368(a)(2)(F).—

(1) IN GENERAL.—Clause (ii) of section 368(a)(2)(F) (relating to certain transactions involving 2 or more investment companies) is amended to read as follows:

"(ii) A corporation meets the requirements of this clause if not more than 25 percent of the value of its total assets is invested in the stock and securities of any one issuer (other than stock in a regulated investment company, a real estate investment trust, or an investment company which meets the requirements of this clause (ii)), and not more than 50 percent of the value of its total assets is invested in the stock and securities of 5 or fewer issuers (other than stock in a regulated investment company, a real estate investment trust, or an investment company which meets the requirements of this clause (ii)). For purposes of this clause, all members of a controlled group of corporations (within the meaning of section 1563(a)) shall be treated as one issuer."

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply as if included in section 2131 of the Tax Reform Act of 1976.

(m) AMENDMENTS RELATING TO SUBCHAPTER S CORPORATIONS.—

(1) IN GENERAL.—

(A) Section 1361(d)(3) (relating to qualified subchapter S trusts) is amended by adding at the end thereof the following new sentence: "A substantially separate and independent share of a trust treated as a separate trust under section 663(c) shall be treated as a separate trust for purposes of this subsection and subsection (c)."

(B) Section 1368(e)(1) (relating to definitions and special rules) is amended by striking out the period at the end of subparagraph (A) and inserting in lieu thereof "and no adjustment shall be made for Federal taxes attributable to any taxable year in which the corporation was a C corporation."

(2) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 1982.

(n) AMENDMENT RELATING TO SECTION 2523.—

(1) IN GENERAL.—Subparagraph (A) of section 2523(f)(4) (relating to election with respect to life estate for donee spouse) is amended to read as follows:

"(A) TIME AND MANNER.—An election under this subsection with respect to any property shall be made on or before the date prescribed by section 6075(b) for filing a gift tax return with respect to the transfer (determined without regard to section 6019(2)) and shall be made in such manner as the Secretary shall by regulations prescribe."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to transfers made after December 31, 1985.

(3) SPECIAL RULE FOR CERTAIN TRANSFERS IN OCTOBER 1984.—An election under section 2523(f) of the Internal Revenue Code of 1954 with respect to an interest in property which—

(A) was transferred during October 1984, and

(B) was transferred pursuant to a trust instrument stating that the grantor's intention was that the property of the trust would constitute qualified terminable interest property as to which a Federal gift tax marital deduction would be allowed upon the grantor's election,

shall be made on the return of tax imposed by section 2501 of such Code for the calendar year 1984 which is filed on or before the due date of such return or, if a timely return is not filed, on the first such return filed after the due date of such return and before December 31, 1986.

(o) AMENDMENTS RELATING TO SECTION 4994.—

(1) For purposes of section 4991(b), a "qualified charitable interest" shall include an economic interest in crude oil held by the Episcopal Royalty Company, an entity created in 1961 as a subsidiary of the Protestant Episcopal Church Foundation of the Diocese of Oklahoma.

(2) The amendment made by this subsection shall apply to oil removed after February 29, 1980.

(p) AMENDMENT RELATED TO SECTION 252 OF THE ECONOMIC RECOVERY TAX ACT OF 1981.—

(1) Notwithstanding subsection (c) of section 252 of the Economic Recovery Tax Act of 1981, the amendment made by subsection (a) of such section 252 (and the provisions of subsection (b) of such section 252) shall apply to any transfer of stock to any person if—

(A) such transfer occurred in November or December of 1973 and was pursuant to the exercise of an option granted in November or December of 1971,

(B) in December 1973 the corporation granting the option was acquired by another corporation in a transaction qualifying as a reorganization under section 368 of the Internal Revenue Code of 1954,

(C) the fair market value (as of July 1, 1974) of the stock received by such person in the reorganization in exchange for the stock transferred to him pursuant to the exercise of such option was less than 50 percent of the fair market value of the stock so received (as of December 4, 1973),

(D) in 1975 or 1976 such person sold substantially all of the stock received in such reorganization, and

(E) such person makes an election under this section at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

(2) LIMITATION ON AMOUNT OF BENEFIT.—Subsection (a) shall not apply to transfers with respect to any employee to the extent that the application of subsection (a) with respect to such employee would (but for this subsection) result in a reduction in liability for income tax with respect to such employee for all taxable years in excess of $100,000 (determined without regard to any interest).

(3) STATUTE OF LIMITATIONS.—

(A) OVERPAYMENTS.—If refund or credit of any overpayment of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, refund or credit of such overpayment (to the extent attributable to the application of subsection (a)) may, nevertheless, be made or allowed if claim therefor is filed before the close of such 6-month period.

(B) DEFICIENCIES.—If the assessment of any deficiency of tax resulting from the application of subsection (a) is prevented on the date of the enactment of this Act (or at any time within 6 months after such date of enactment) by the operation of any law or rule of law, assessment of such deficiency (to the extent attributable to the application of subsection (a)) may, nevertheless, be made within such 6-month period.

(q) TREATMENT OF CERTAIN SELF-INSURED WORKERS' COMPENSATION FUNDS.—

(1) MORATORIUM ON COLLECTION ACTIVITIES.—During the period beginning on the date of the enactment of this Act and ending on August 16, 1987, the Secretary of the Treasury or his delegate—

(A) shall suspend any pending audit of any self-insured workers' compensation fund where the audit involves the issue of whether such fund is a mutual insurance company,

(B) shall not initiate any audit of any such fund involving such issue, and

(C) shall take no steps to collect from such fund any underpayment, interest, or penalty involving such issue.

(2) SUSPENSION OF RUNNING OF INTEREST.—No interest shall be payable under chapter 67 of the Internal Revenue Code of 1986 on any underpayment by a self-insured workers' compensation fund involving such issue for the period beginning on August 16, 1986, and ending on August 16, 1987.

(3) ADDITIONAL TIME TO FILE TAX COURT PROCEEDING.—If the period during which a petition involving such issue could have been filed with the Tax Court by any self-insured workers' compensation fund had not expired before August 16, 1986, such period shall not expire before August 16, 1987.

(4) SELF-INSURED WORKERS' COMPENSATION FUND.—For purposes of this subsection, the term "self-insured workers' compensation fund" means any self-insured workers' compensation fund established pursuant to applicable State law regulating self-insured workers' compensation funds.

(r) RETURNS OF ALCOHOL, TOBACCO, AND FIREARMS TAXES.—

(1) IN GENERAL.—Subsection (b) of section 6091 of such Code (relating to place for filing returns or other documents) is amended by adding at the end thereof the following new paragraph:

"(6) ALCOHOL, TOBACCO, AND FIREARMS RETURNS, ETC.—In the case of any return of tax imposed by subtitle E (relating to taxes on alcohol, tobacco, and firearms), subsection (a) shall apply (and this subsection shall not apply)."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall take effect on the first day of the first calendar month which begins more than 90 days after the date of the enactment of this Act.

(s) TREATMENT OF STRIPPING TAX-EXEMPT BONDS.

(1) IN GENERAL.—Subsection (d) of section 1286 is amended to read as follows:

"(d) SPECIAL RULES FOR TAX-EXEMPT OBLIGATIONS.—In the case of any tax-exempt obligation (as defined in section 1275(a)(3)) from which 1 or more coupons have been stripped—

"(1) the amount of original issue discount determined under subsection (a) with respect to any stripped bond or stripped coupon from such obligation shall be the amount which produces a yield to maturity (as of the purchase date) equal to the lower of—

"(A) the coupon rate of interest on such obligation before the separation of coupons, or

"(B) the yield to maturity (on the basis of purchase price) of the stripped obligation or coupon,

"(2) the amount of original issue discount determined under paragraph (1) shall be taken into account in determining the adjusted basis of the holder under section 1288,

"(3) subsection (b)(1) shall not apply, and

"(4) subsection (b)(2) shall be applied by increasing the basis of the bond or coupon by the interest accrued but not paid before the time such bond or coupon was disposed of (and not previously reflected in basis)."

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to any purchase or sale of any stripped tax-exempt obligation or stripped coupon from such an obligation after the date of the enactment of this Act.

(t) DISPOSITION OF CERTAIN SUBSIDIARY.—If for a taxable year of an affiliated group filing a consolidated return ending on or before December 31, 1987, there is 1 disposition of stock of a subsidiary incorporated in Delaware on December 24, 1969, and whose principal place of business is in New Orleans, Louisiana (within the meaning of Treasury Regulation section 1.1502–19), the amount required to be included in income with respect to such disposition under Treasury Regulation section 1.1502–19(a) shall, notwithstanding such section, be included in income ratably over the 15-year period beginning with the taxable year in which the disposition occurs and ending with the 14th succeeding taxable year.

(u) AMENDMENTS RELATED TO SINGLE EMPLOYER PENSION PLAN AMENDMENTS ACT OF 1986.—

(1) CLARIFICATION OF APPLICABILITY OF NOTICE REQUIREMENT FOR SIGNIFICANT REDUCTIONS IN BENEFIT ACCRUALS.—Section 206(h) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054(h); 100 Stat. 243) is amended—

(A) by striking out "single-employer plan" and inserting in lieu thereof "plan described in paragraph (2)";

(B) by redesignating paragraphs (1), (2), and (3) as subparagraphs (A), (B), and (C), respectively;

(C) by striking out "paragraph (1), (2), or (3)" and inserting in lieu thereof "subparagraph (A), (B), or (C)";

(D) by inserting "(1)" after "(h)"; and

(E) by adding at the end the following new paragraph:

"(2) A plan is described in this paragraph if such plan is—

"(A) a defined benefit plan, or

"(B) an individual account plan which is subject to the funding standards of section 302."

(2) TREATMENT OF SECTION 4049 TRUSTS ESTABLISHED PURSUANT TO SECTION 4042(i).—Section 4049(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1349(a); 100 Stat. 258) is amended by inserting "or 4042(i)" after "section 4041(c)(3)(B) (ii) or (iii)".

(3) CORRECTION OF DEFINITION OF MULTIEMPLOYER PLAN FOR PURPOSES OF TITLE I.—Section 11016(c)(1) of the Single-Employer Pension Plan Amendments Act of 1986 (100 Stat. 273) and the amendment made thereby are repealed.

(4) EFFECTIVE DATE.—

(A) GENERAL RULE.—Except as provided in subparagraph (B), the preceding provisions of this subsection shall be effective as if such provisions were included in the enactment of the Single-Employer Pension Plan Amendments Act of 1986.

(B) SPECIAL RULE.—Subparagraph (B) of section 206(h)(2) of the Employee Retirement Income Security Act of 1974 (as

amended by paragraph (1)) shall apply only with respect to plan amendments adopted on or after the date of the enactment of this Act.

CHAPTER 8—EFFECTIVE DATE

SEC. 1881. EFFECTIVE DATE.

Except as otherwise provided in this subtitle, any amendment made by this subtitle shall take effect as if included in the provision of the Tax Reform Act of 1984 to which such amendment relates.

Subtitle B—Related to Other Programs Affected by the Deficit Reduction Act of 1984

CHAPTER 1—AMENDMENTS RELATED TO SOCIAL SECURITY ACT PROGRAMS

SEC. 1882. AMENDMENTS RELATED TO COVERAGE OF CHURCH EMPLOYEES (SECTION 2603 OF THE DEFICIT REDUCTION ACT).

(a) CLARIFICATION OF EXCEPTION FOR MEMBERS OF CERTAIN RELIGIOUS FAITHS.—Subsection (g) of section 1402 of the Internal Revenue Code of 1954 (relating to members of certain religious faiths) is amended by adding at the end thereof the following new paragraph:

"(5) SUBSECTION NOT TO APPLY TO CERTAIN CHURCH EMPLOYEES.—This subsection shall not apply with respect to services which are described in subparagraph (B) of section 3121(b)(8) (and are not described in subparagraph (A) of such section)."

(b) TREATMENT OF INCOME OF CERTAIN CHURCH, ETC., EMPLOYEES.—

(1) AMENDMENTS OF INTERNAL REVENUE CODE OF 1954.—

(A) IN GENERAL.—Section 1402 of such Code (relating to definitions for purposes of the tax on self-employment income) is amended by adding at the end thereof the following new subsection:

"(j) SPECIAL RULES FOR CERTAIN CHURCH EMPLOYEE INCOME.—

"(1) COMPUTATION OF NET EARNINGS.—In applying subsection (a)—

"(A) church employee income shall not be reduced by any deduction;

"(B) church employee income and deductions attributable to such income shall not be taken into account in determining the amount of other net earnings from self-employment.

"(2) COMPUTATION OF SELF-EMPLOYMENT INCOME.—

"(A) SEPARATE APPLICATION OF SUBSECTION (b)(2).—Paragraph (2) of subsection (b) shall be applied separately—

"(i) to church employee income, and

"(ii) to other net earnings from self-employment.

"(B) $100 FLOOR.—In applying paragraph (2) of subsection (b) to church employee income, '$100' shall be substituted for '$400'.

"(3) Coordination with subsection (a)(12).—Paragraph (1) shall not apply to any amount allowable as a deduction under subsection (a)(12), and paragraph (1) shall be applied before determining the amount so allowable.

"(4) Church employee income defined.—For purposes of this section, the term 'church employee income' means gross income for services which are described in section 3121(b)(8)(B) (and are not described in section 3121(b)(8)(A))."

(B) Technical and conforming amendments.—

(i) Net earnings.—Paragraph (14) of section 1402(a) of such Code (defining net earnings from self-employment) is amended to read as follows:

"(14) in the case of church employee income, the special rules of subsection (j)(1) shall apply."

(ii) Self-employment income.—Subsection (b) of section 1402 of such Code is amended by adding at the end thereof the following new sentence: "In the case of church employee income, the special rules of subsection (j)(2) shall apply for purposes of paragraph (2)."

(iii) Conforming amendment.—The second sentence of section 1402(b) of such Code is amended by striking out "clause (1)" and inserting in lieu thereof "paragraph (1)".

(2) Amendments of social security act.—

(A) In general.—Section 211 of the Social Security Act is amended by adding at the end thereof the following new subsection:

"(i)(1) In applying subsection (a)—

"(A) church employee income shall not be reduced by any deduction;

"(B) church employee income and deductions attributable to such income shall not be taken into account in determining the amount of other net earnings from self-employment.

"(2)(A) Subsection (b)(2) shall be applied separately—

"(i) to church employee income, and

"(ii) to other net earnings from self-employment.

"(B) In applying subsection (b)(2) to church employee income, '$100' shall be substituted for '$400'.

"(3) Paragraph (1) shall not apply to any amount allowable as a deduction under subsection (a)(11), and paragraph (1) shall be applied before determining the amount so allowable.

"(4) For purposes of this section, the term 'church employee income' means gross income for services which are described in section 210(a)(8)(B) (and are not described in section 210(a)(8)(A))."

(B) Technical and conforming amendments.—

(i) Net earnings.—Section 211(a)(13) of such Act is amended to read as follows:

"(13) In the case of church employee income, the special rules of subsection (i)(1) shall apply."

(ii) Self-employment income.—Section 211(b) of such Act is amended by adding at the end thereof the following new sentence: "In the case of church employee income, the special rules of subsection (i)(2) shall apply for purposes of paragraph (2)."

(3) Effective date.—The amendments made by this subsection shall apply to remuneration paid or derived in taxable years beginning after December 31, 1985.

(c) Revocation of Election Under Section 3121(w).—Paragraph (2) of section 3121(w) of the Internal Revenue Code of 1954 (relating to timing and duration of election) is amended by striking out the last 2 sentences and inserting in lieu thereof the following: "The election may be revoked by the church or organization under regulations prescribed by the Secretary. The election shall be revoked by the Secretary if such church or organization fails to furnish the information required under section 6051 to the Secretary for a period of 2 years or more with respect to remuneration paid for such services by such church or organization, and, upon request by the Secretary, fails to furnish all such previously unfurnished information for the period covered by the election. Any revocation under the preceding sentence shall apply retroactively to the beginning of the 2-year period for which the information was not furnished."

SEC. 1883. TECHNICAL CORRECTIONS IN OTHER PROVISIONS RELATED TO SOCIAL SECURITY ACT PROGRAMS.

(a) Amendments Relating to OASDI Program.—

(1) Section 202(c)(5)(B) of the Social Security Act is amended by striking out "or (I)" and inserting in lieu thereof "or (J)".

(2) Section 202(q)(5)(A)(i) of such Act is amended by striking out "prescribed by him" and inserting in lieu thereof "prescribed by the Secretary".

(3) Section 202(q)(5)(C) of such Act is amended by striking out "she shall be deemed" and inserting in lieu thereof "he or she shall be deemed".

(4) Section 210(a)(5)(G) of such Act is amended by striking out "Any other service" and inserting in lieu thereof "any other service".

(5) Effective on the date of the enactment of the Deficit Reduction Act of 1984—

(A) section 2601(d)(1)(B)(ii) of that Act is amended by striking out "210(a)(5)(g)(iii)" and inserting in lieu thereof "210(a)(5)(G)(iii)"; and

(B) section 2663(c)(1) of that Act is amended by striking out subparagraph (B).

(6) Section 211(c)(2) of the Social Security Act is amended by indenting subparagraph (G) two additional ems (for a total indentation of four ems) so as to align its left margin with the margins of the other subparagraphs in such section.

(7) Section 215(i)(5)(B) of such Act is amended—

(A) by striking out "subdivision (I)" in clause (ii) and inserting in lieu thereof "clause (i)(I)"; and

(B) by striking out "subdivisions (I) and (II)" in the matter between clauses (iii) and (iv) and inserting in lieu thereof "clause (i)".

(8) The heading of section 218(m) of such Act is amended to read as follows:

"Wisconsin Retirement Fund".

(9) Section 221(e) of such Act is amended by striking out "under this section" in the first sentence.

(10) Section 223(g)(1) of such Act is amended by striking out the second comma after the term "benefits" where such term first appears in the matter following subparagraph (C).

(11)(A) Section 1402(c)(2) of the Internal Revenue Code of 1954 is amended by indenting subparagraph (G) two additional ems (for a total indentation of four ems) so as to align its left margin with the margins of the other subparagraphs in such section.

(B) Section 3121(a)(8) of such Code is amended by moving subparagraph (B) two ems to the left, so that its left margin is in flush alignment with the margin of subparagraph (A) of such section.

(b) AMENDMENTS RELATING TO AFDC AND CHILD SUPPORT PROGRAMS.—

(1)(A) Section 402(a)(31)(A) of the Social Security Act is amended by striking out "(or such lesser amount as the Secretary may prescribe in the case of an individual not engaged in fulltime employment or not employed throughout the month)".

(B) The amendment made by this paragraph shall be effective beginning October 1, 1984.

(2)(A) Section 402(a)(38)(B) of such Act is amended by striking out "section 406(a)," and inserting in lieu thereof "section 406(a) or in section 407(a) (if such section is applicable to the State),".

(B) Section 402(a)(38) of such Act (as amended by subparagraph (A) of this paragraph) is further amended by relocating so much of subparagraph (B) as follows "section 407(a) (if such section is applicable to the State)," and placing it after and below subparagraph (B), beginning flush, and indenting it two ems so that its left margin is aligned with the left margin of that portion of section 402(a)(38) that precedes subparagraph (A) thereof.

(C) The amendments made by this paragraph shall be effective beginning October 1, 1984.

(3)(A) Section 402(a)(39) of such Act is amended by striking out "under the age selected by the State pursuant to section 406(a)(2)" and inserting in lieu thereof "under the age of 18".

(B) The amendment made by subparagraph (A) shall be effective beginning October 1, 1984.

(4)(A) Section 402(a) of such Act is amended by striking out "and" after the semicolon at the end of paragraph (37), and by making any additional changes which may be necessary to assure that paragraphs (34) through (37) each end with a semicolon, paragraph (38) ends with "; and", and paragraph (39) ends with a period.

(B) Effective on the date of the enactment of the Deficit Reduction Act of 1984, section 2639(a) of that Act is amended by striking out the period immediately following "utility providing home energy" (in the quoted matter) and inserting in lieu thereof a semicolon.

(5) The placement of the last sentence of section 402(a) of the Social Security Act is modified to the extent necessary to assure that it begins flush to the full left margin without any indentation, immediately after and below the last of the numbered paragraphs.

(6) Section 457(c) of such Act is amended by striking out "subsection (b)(3) (A) and (B)" in the matter following paragraph (2) and inserting in lieu thereof "subsection (b)(4) (A) and (B)".

(7) Section 458(d) of such Act is amended by striking out "on behalf of individuals residing in another State" and inserting in lieu thereof "at the request of another State".

(8) Section 464(b)(2)(A) of such Act is amended by striking out "threshhold" and inserting in lieu thereof "threshold".

(9) Section 474(a) of such Act is amended by moving paragraph (4) two ems to the left, so that its left margin is in flush alignment with the margins of the preceding paragraphs.

(10)(A) Part E of title IV of such Act is amended by adding at the end thereof the following new section:

"EXCLUSION FROM AFDC UNIT OF CHILD FOR WHOM FOSTER CARE MAINTENANCE PAYMENTS ARE MADE

"SEC. 478. Notwithstanding any other provision of this title, a child with respect to whom foster care maintenance payments are made under this part shall not, for the period for which such payments are made, be regarded as a member of a family for purposes of determining the amount of the benefits of the family under part A, and the income and resources of such child shall not be counted as the income and resources of a family under such part.".

(B) The amendment made by subparagraph (A) shall become effective October 1, 1984.

(11)(A) The failure by a State to comply with the provisions of any amendment made by paragraph (1), (2), (3), or (10) or the imposition by a State of any requirement inconsistent with such provisions, in the administration of its plan approved under section 402(a) of the Social Security Act during the period beginning October 1, 1984, and ending on the day preceding the date of the enactment of this Act, shall not be considered to be failure to comply substantially with a provision required to be included in the State's plan, or to constitute (solely by reason of such inconsistency) the imposition of a prohibited requirement in the administration of the plan, for purposes of section 404(a) of such Act.

(B) No State shall be considered to have made any overpayment or underpayment of aid, under its plan approved under section 402(a) of the Social Security Act, by reason of its compliance or noncompliance with the provisions of any amendment made by paragraph (1), (2), (3), or (10) (or solely because of the extent to which its requirements are consistent or inconsistent with such provisions) in the administration of the plan during the period specified in subparagraph (A).

(c) AMENDMENTS TO GENERAL PROVISIONS.—

(1) Section 1101(a) of such Act is amended by shifting paragraphs (3), (4), and (5) to the right to the extent necessary to

assure that their left margins are aligned with the left margins of the other numbered paragraphs.

(2) Section 1136(b)(7) of such Act is amended by striking out "nongovermental" and inserting in lieu thereof "nongovernmental".

(d) AMENDMENTS RELATING TO SSI PROGRAM.—

(1) The heading of section 1631(g) of such Act is amended to read as follows:

"Reimbursement to States for Interim Assistance Payments".

(2) Section 1612(a)(1)(C) of such Act is amended by striking out "section 43" and inserting in lieu thereof "section 32".

(3) Section 1612(b) of such Act is amended—

(A) by striking out the semicolon at the end of paragraph (2)(A) and inserting in lieu thereof "; and";

(B) by striking out the period at the end of paragraph (2)(B) and inserting in lieu thereof a semicolon; and

(C) by making any changes which may be necessary to assure that paragraph (11) ends with a semicolon, paragraph (12) ends with "; and", and paragraph (13) ends with a period.

(e) AMENDMENTS RELATING TO SOCIAL SERVICES PROGRAM.—

(1)(A) Section 2003(d) of such Act is repealed.

(B) Section 2003(b) of such Act is amended by striking out "(subject to subsection (d))".

(2) Section 2007 of such Act is repealed.

(f) EFFECTIVE DATE.—Except as otherwise provided in this section, the amendments made by this section shall take effect on the date of the enactment of this Act.

CHAPTER 2—AMENDMENTS RELATED TO UNEMPLOYMENT COMPENSATION PROGRAM

SEC. 1884. TECHNICAL CORRECTIONS IN FEDERAL UNEMPLOYMENT TAX ACT.

The Federal Unemployment Tax Act is amended as follows:

(1) Subparagraph (B) of section 3302(c)(2) (relating to a limit on the credit against the unemployment tax) is amended—

(A) by striking out "determination" the second place it appears in the material preceding clause (i) and inserting in lieu thereof "denominator", and

(B) in clause (i)—

(i) by striking out "percent" immediately preceding the comma at the end thereof, and

(ii) by inserting "percent" after "2.7".

(2) Subparagraph (A) of section 3302(f)(8) (relating to a partial limitation on the reduction of the credit against the unemployment tax) is amended by striking out "1987" and inserting in lieu thereof "1986".

(3) Clause (i) of section 3306(o)(1)(A) (relating to crew leaders who are registered or provide specialized agricultural labor) is amended by striking out "Farm Labor Contractor Registration

Act of 1963" and inserting in lieu thereof "Migrant and Seasonal Agricultural Worker Protection Act".

CHAPTER 3—AMENDMENTS RELATED TO TRADE AND TARIFF PROGRAMS

SEC. 1885. AMENDMENTS TO THE TARIFF SCHEDULES.

(a) IN GENERAL.—The Tariff Schedules of the United States are amended as follows:

(1) TELECOMMUNICATIONS PRODUCT CLASSIFICATION CORRECTIONS.—

(A) Schedule 6 is amended as follows:

(i) Headnote 1 to subpart C of part 4 is amended by striking out "688.43" and inserting in lieu thereof "688.42".

(ii) Headnote 3 of part 5 of schedule 6 is amended by striking out "items 685.11 through 685.19, inclusive," and inserting in lieu thereof "items 684.92, 684.98, 685.00, and 685.08".

(iii) Item 685.34 is amended by inserting "35% ad val." in Column No. 2.

(iv) Item 685.55 is amended by striking out "685.11 to 685.50" and inserting in lieu thereof "684.92 to 685.49".

(B) Headnote 2(ii) to part 7 of schedule 8 is amended by striking out "688.43" and inserting in lieu thereof "688.42".

(C) Subpart B of part 2 of schedule 6 is amended by inserting before the superior heading to items 608.26 and 608.29, and at the same indention level as that heading, the following new item:

"608.25	Silicon electrical steel	5.6% ad val. + additional duties (see headnote 4)	5.1% ad val. + additional duties (see headnote 4) (D) Free (E, I)	33% ad val. additional duties (see headnote 4)"

(2) CORRECTIONS TO THE APPENDIX.—Subpart B of part 1 to the Appendix is amended as follows:

(A) The article description for item 906.38 is amended to read as follows: "N-Acetylsulfanilyl chloride (provided for in item 405.31, part 1B, schedule 4)".

(B) Item 907.38 is amended by striking out "411.87" and inserting in lieu thereof "411.82".

(C) Item 912.13 is amended by striking out "670.20" and inserting in lieu thereof "670.21".

(D) Item 907.63 is amended by striking out "(provided for in item 437.13" and inserting in lieu thereof "put up in measured doses in chewing gum form (provided for in item 438.02".

(3) MISCELLANEOUS CORRECTIONS.—The Schedules are further amended as follows:

(A) Headnote 1 of subpart D of part 4 of schedule 1 is amended by striking out "(casein plus albumin)" and inserting in lieu thereof "(casein plus lactalbumin)".

(B) Headnote 1 of subpart C of part 4 of schedule 3 is amended—

(i) by inserting "or" after the semicolon at the end of clause (v); and

(ii) by striking out "; or" at the end of clause (vi) and inserting in lieu thereof a period.

(b) EFFECTIVE DATE.—

(1) The amendments made by this section shall apply with respect to articles entered, or withdrawn from warehouse, for consumption on or after the date that is 15 days after the date of enactment of this Act.

(2) Notwithstanding section 514 of the Tariff Act of 1930 or any other provision of law, upon proper request filed with the customs officer concerned on or before the date that is 90 days after the date of enactment of this Act, the entry of any article—

(A) which was made on or after November 14, 1984, and before the date that is 15 days after the date of enactment of this Act; and

(B) with respect to which there would have been no duty, or a lesser duty, by reason of any amendment made by subsection (a) if such entry were made on or after the date that is 15 days after the date of enactment of this Act,

shall be liquidated or reliquidated as though such entry had been made on the date that is 15 days after the date of enactment of this Act.

(3) The rate of duty in column number 1 for item 608.25 of the Tariff Schedules of the United States shall be subject to all staged rate reductions for item 608.38 of such Schedules that—

(A) take effect after the date of enactment of this Act, and

(B) were proclaimed by the President before the date of enactment of this Act.

SEC. 1886. TECHNICAL CORRECTIONS TO COUNTERVAILING AND ANTIDUMPING DUTY PROVISIONS.

(a) IN GENERAL.—Title VII of the Tariff Act of 1930 is amended as follows:

(1)(A) Subsection (c) of section 701 (19 U.S.C. 1671(c)) is redesignated as subsection (d).

(B) Subsection (g) of such section 701 (as added by section 613(b) of the Trade and Tariff Act of 1984) is—

(i) amended by striking out "(g) Whenever" and inserting in lieu thereof "(c) UPSTREAM SUBSIDY.—Whenever"; and

(ii) inserted immediately after subsection (b) of that section.

(2) Sections 702(b)(1), 732(b)(1), and 733(b)(2) (19 U.S.C. 1671a(b)(1); 1673a(b)(1); 1673b(b)(2)) are each amended by striking out "(C), (D), or (E)" each place it appears and inserting in

lieu thereof "(C), (D), (E), or (F)"

(3) Subsection (h) of section 703 (19 U.S.C. 1671b(h)) is redesignated as subsection (g), and—

(A) paragraph (2)(A) of that subsection (as so redesignated) is amended by striking out "days under section 705(a)(1) or 225 days under section 705(a)(2), as appropriate" and inserting in lieu thereof "or 225 days, as appropriate, under section 705(a)(1)"; and

(B) paragraph (2)(B)(ii) of that subsection (as so redesignated) is amended by striking out "days under section 705(a)(2)" and inserting in lieu thereof "or 225 days, as appropriate, under section 705(a)(1)".

(4) Section 704 is amended—

(A) by amending subsection (d)—

(i) by redesignating paragraph (2) as paragraph (3); and

(ii) by inserting after paragraph (1) the following new paragraph:

"(2) EXPORTS OF MERCHANDISE TO UNITED STATES NOT TO INCREASE DURING INTERIM PERIOD.—The administering authority may not accept any agreement under subsection (b) unless that agreement provides a means of ensuring that the quantity of the merchandise covered by that agreement exported to the United States during the period provided for elimination or offset of the subsidy or cessation of exports does not exceed the quantity of such merchandise exported to the United States during the most recent representative period determined by the administering authority."; and

(B) by amending subsection (i)(1)(D) by striking out "international" and inserting in lieu thereof "intentional".

(5) Paragraph (2) of section 706(a) is amended by aligning the margin of the matter appearing after subparagraph (B) with the margin of the matter appearing before subparagraph (A).

(6)(A) Section 708 is amended by striking out "SEC. 708." and inserting in lieu thereof the following flush section heading:

"SEC. 708. EFFECT OF DEROGATION OF EXPORT-IMPORT BANK FINANCING.".

(B) The table of contents for such title VII is amended by inserting in numerical sequence the following:

"Sec. 708. Effect of derogation of Export-Import Bank financing."

(7) Paragraph (1) of section 736(c) (19 U.S.C. 1673e(c)(1)) is amended by inserting ", and was sold to any person that is not related to such manufacturer, producer, or exporter," immediately before "on or after the date of publication of—".

(8) The last sentence of section 751(b)(1) (19 U.S.C. 1675(b)(1)) is amended by inserting "or countervailing duty" after "antidumping" each place it appears.

(9) Clause (i) of section 771(7)(F) (19 U.S.C. 1677(7)(F)(i)) is amended—

(A) by striking "any merchandise" in that part which precedes subclause (I) and inserting in lieu thereof "the merchandise"; and

(B) by striking out "find orders" in subclause (VIII) and inserting in lieu thereof "final orders".

(10) Subsection (a) of section 771A (19 U.S.C. 1677-1(a)) is amended by striking out "(ii), or (iii)" and inserting in lieu thereof "(ii), (iii), or (iv)".

(11) Subsection (g) of section 773 (19 U.S.C. 1677b(g)) is redesignated as subsection (f).

(12) Section 775 (19 U.S.C. 1677d) is amended by striking out "an proceeding" each place it appears in the text and in the heading and inserting in lieu thereof "a proceeding".

(13) Section 777 (19 U.S.C. 1677f) is amended—

(A) by striking out "confidential", "nonconfidential", and "confidentiality" each place they appear in the text and in the side headings and inserting in lieu thereof "proprietary", "non-proprietary", and "proprietary status", respectively; and

(B) by inserting "or the Commission" after "administering authority" in subsection (b)(1)(B)(i).

(b) AMENDMENTS TO EFFECTIVE DATE PROVISIONS.—Section 626(b) of the Trade and Tariff Act of 1984 (relating to the effective dates of the amendments made therein to title VII of the Tariff Act of 1930) is amended—

(1) by amending paragraph (1) by inserting ", and to reviews begun under section 751 of that Act," after "1930"; and

(2) by adding at the end thereof the following new paragraphs:

"(3) The administering authority may delay implementation of any of the amendments referred to in subsections (a) and (b)(1) with respect to any investigation in progress on the date of enactment of this Act if the administering authority determines that immediate implementation would prevent compliance with a statutory deadline in title VII of the Tariff Act of 1930 that is applicable to that investigation.

"(4) The amendment made by section 621 shall apply with respect to merchandise that is unliquidated on or after November 4, 1984.".

SEC. 1887. AMENDMENTS TO THE TRADE ACT OF 1974.

(a) IN GENERAL.—The Trade Act of 1974 is amended as follows:

(1) Subclause (II) of section 102(b)(4)(B)(ii) of the Trade Act of 1974 (19 U.S.C. 2112(b)(4)(B)(ii)(II)) is amended by striking out "subsection (A)(ii)(I)" and inserting in lieu thereof "subparagraph (A)(ii)(I)".

(2) Subsection (n) of section 135 (as added by section 306(c)(2)(B)(v) of the Trade and Tariff Act of 1984) is redesignated as subsection (m).

(3) Section 141(d)(6) is amended by striking out "3679(b) of the Revised Statutes (31 U.S.C. 665(b))" and inserting in lieu thereof "1342 of title 31, United States Code".

(4) Subsection (d) of section 141 (19 U.S.C. 2171(d)) is amended—

(A) by striking out "and" at the end of paragraph (9),

(B) by striking out the period at the end of paragraph (10) and inserting in lieu thereof "; and", and

(C) by redesignating the paragraph added by section 304(d)(2)(A)(iii) of the Trade and Tariff Act of 1984 as paragraph (11).

(5) Subparagraphs (A), (B), and (C) of section 502(b)(4) (19 U.S.C. 2462(b)(4)) are amended to read as follows:

"(A) has nationalized, expropriated, or otherwise seized ownership or control of property, including patents, trademarks, or copyrights, owned by a United States citizen or by a corporation, partnership, or association which is 50 percent or more beneficially owned by United States citizens,

"(B) has taken steps to repudiate or nullify an existing contract or agreement with a United States citizen or a corporation, partnership, or association which is 50 percent or more beneficially owned by United States citizens, the effect of which is to nationalize, expropriate, or otherwise seize ownership or control of property, including patents, trademarks, or copyrights, so owned, or

"(C) has imposed or enforced taxes or other exactions, restrictive maintenance or operational conditions, or other measures with respect to property, including patents, trademarks, or copyrights, so owned, the effect of which is to nationalize, expropriate, or otherwise seize ownership or control of such property,".

(6) That part of section 504(c)(3)(D)(ii) (19 U.S.C. 2464(c)(3)(D)(ii)) that precedes subclause (I) is amended—

(A) by striking out "from any beneficiary developing country";

(B) by striking out "1984 which exceeds 15" and inserting in lieu thereof "1986 the aggregate value of which exceeds 15"; and

(C) by striking out "if for the preceding calendar year such beneficiary developing country—" and inserting in lieu thereof "from those beneficiary developing countries which for the preceding calendar year—".

(b) Transistors.—

(1) Section 128(b) of the Trade Act of 1974 (19 U.S.C. 2138) is amended by striking out "587.70" in paragraph (1) and inserting in lieu thereof "687.70".

(2)(A) Item 687.70 of the Tariff Schedules of the United States is amended by striking out "4.2% ad val." and inserting in lieu thereof "Free".

(B) The amendment made by subparagraph (A) shall apply with respect to articles entered, or withdrawn from warehouse, for consumption on or after the date that is 15 days after the date of enactment of this Act.

(C) Notwithstanding section 514 of the Tariff Act of 1930 or any other provision of law, upon proper request filed with the customs officer concerned on or before the date that is 90 days after the date of enactment of this Act, the entry of any article described in item 687.70 of the Tariff Schedules of the United States which was made on or after March 1, 1985, and before the date that is 15 days after the date of enactment of this Act shall be liquidated or reliquidated as though such entry had

been made on the date that is 15 days after the date of enactment of this Act.

SEC. 1888. AMENDMENTS TO THE TARIFF ACT OF 1930.

The Tariff Act of 1930 is amended as follows:

(1) Subsection (c) of section 304 (19 U.S.C. 1304(c)) is amended—

(A) by striking out "No" and inserting in lieu thereof the following: "(1) Except as provided in paragraph (2), no"; and

(B) by adding at the end thereof the following new paragraph:

"(2) If, because of the nature of an article, it is technically or commercially infeasible to mark it by one of the four methods specified in paragraph (1), the article may be marked by an equally permanent method of marking such as paint stenciling or, in the case of small diameter pipe, tube, and fittings, by tagging the containers or bundles.".

(2) Subsection (j) of section 313 (19 U.S.C. 1313(j)) is amended—

(A) by redesignating the paragraphs (3) and (4) inserted by section 202(1)(B) of the Trade and Tariff Act of 1984 as paragraphs (2) and (3), respectively; and

(B) by amending the paragraph redesignated as paragraph (4) by section 202(1)(A) of the Trade and Tariff Act of 1984 to read as follows:

"(4) The performing of incidental operations (including, but not limited to, testing, cleaning, repacking, and inspecting) on—

"(A) the imported merchandise itself in cases to which paragraph (1) applies, or

"(B) the merchandise of the same kind and quality in cases to which paragraph (2) applies,

that does not amount to manufacture or production for drawback purposes under the preceding provisions of this section shall not be treated as a use of that merchandise for purposes of applying paragraph (1)(B) or (2)(C).".

(3) Section 339(c)(2)(A) (19 U.S.C. 1339) is amended by striking out "relief" and inserting in lieu thereof "injury".

(4) Section 514(a) (19 U.S.C. 1514(a)) is amended by striking out "as defined in section 771(9) (C), (D), (E), and (F) of this Act".

(5) Section 516(a)(2) (19 U.S.C. 1516(a)(2)) is amended by adding at the end thereof the following new sentence: "Such term includes an association, a majority of whose members is composed of persons described in subparagraph (A), (B), or (C).".

(6) Section 516A(a)(3) (19 U.S.C. 1516a(a)(3)) is amended by striking out "(2)(A)(ii)" and inserting in lieu thereof "(2)(A)(i)(II)".

(7) Section 613a of the Tariff Act of 1930 (19 U.S.C. 1613a), as added by section 317 of the Joint Resolution entitled "A Joint Resolution making appropriations for fiscal year 1985, and for other purposes.", approved October 12, 1984 (98 Stat. 2054, Public Law 98-473), is repealed.

(8) Section 641 (19 U.S.C. 1641) is amended by adding at the end thereof the following new subsection:

"(i) Compensation of Ocean Freight Forwarders.—

"(1) In general.—Notwithstanding any other provision of law, no conference or group of two or more ocean common carriers in the foreign commerce of the United States that is authorized to agree upon the level of compensation paid to ocean freight forwarders may—

"(A) deny to any member of such conference or group the right, upon notice of not more than 10 calendar days, to take independent action on any level of compensation paid to an ocean freight forwarder who is also a customs broker, and

"(B) agree to limit the payment of compensation to an ocean freight forwarder who is also a customs broker to less than 1.25 percent of the aggregate of all rates and charges applicable under the tariff assessed against the cargo on which the forwarding services are provided.

"(2) Administration.—The provisions of this subsection shall be enforced by the agency responsible for administration of the Shipping Act of 1984 (46 U.S.C. 1701, et seq.).

"(3) Remedies.—Any person injured by reason of a violation of paragraph (1) may, in addition to any other remedy, file a complaint for reparation as provided in section 11 of the Shipping Act of 1984 (46 U.S.C. 1710), which may be enforced pursuant to section 14 of such Act (46 U.S.C. 1713).

"(4) Definitions.—For purposes of this subsection, the terms 'conference', 'ocean common carrier', and 'ocean freight forwarder' have the respective meaning given to such terms by section 3 of the Shipping Act of 1984 (46 U.S.C. 1702)."

SEC. 1889. AMENDMENTS TO THE TRADE AND TARIFF ACT OF 1984.

The Trade and Tariff Act of 1984 (Public Law 98-573) is amended as follows:

(1) Section 126 is amended by striking out the following:

"(3) Paragraphs (1) and (2) of section 126 of the bill are amended to read as follows:".

(2) Section 174(b) is amended by adding at the end of the table appearing therein the following:

"January 1, 1987 .... 4.9% ad val.".

(3) Paragraph (7) of subsection (b) of section 212 is redesignated as subsection (c) of that section.

(4) The table in section 234(a) is amended by striking out "711.49" and inserting in lieu thereof "712.49".

(5) Paragraph (3) of section 307(b) is amended by striking out "or paragraph (3)".

(6) Paragraph (4) of section 404(e) is amended by striking out "147.44" and inserting in lieu thereof "147.33".

(7) Section 504 is amended by striking out "Tariff Act of 1930" and inserting in lieu thereof "Trade Act of 1974".

(8) Paragraph (3) of section 619 is amended by striking out "subsection (b)" and inserting in lieu thereof "subsection (b)(1)".

SEC. 1890. AMENDMENTS TO THE CARIBBEAN BASIN ECONOMIC RECOVERY ACT.

Section 213 of the Caribbean Basin Economic Recovery Act (19 U.S.C. 2703) is amended—

(1) by amending paragraph (3) of subsection (a) (as added by section 235 of the Trade and Tariff Act of 1984)—

(A) by redesignating that paragraph as paragraph (4), and aligning its margin with that of paragraph (3), and

(B) by striking out "such" the first time it appears therein and inserting in lieu thereof "any beneficiary"; and

(2) by striking out "138.42" in subsection (f)(5)(B) and inserting in lieu thereof "138.46".

SEC. 1891. CONFORMING AMENDMENTS REGARDING CUSTOMS BROKERS.

Title 28 of the United States Code is amended—

(1) by striking out "(3) or (c)" in section 1581(g)(1) and inserting in lieu thereof "(3)"; and

(2) by striking out "641(a)(1)(C)" in section 1582(1) and inserting in lieu thereof "641(b)(6)".

SEC. 1892. SPECIAL EFFECTIVE DATE PROVISIONS FOR CERTAIN ARTICLES GIVEN DUTY-FREE TREATMENT UNDER THE TRADE AND TARIFF ACT OF 1984.

(a) IN GENERAL.—Notwithstanding section 514 of the Tariff Act of 1930 or any other provision of law, upon proper request filed with the appropriate customs officer on or before the date that is 90 days after the date of enactment of this Act, any entry—

(1) which was made after the applicable date and before November 14, 1984, and

(2) with respect to which there would have been no duty or a lesser duty by reason of any amendment made by section 112, 115, 118, 167, or 179 of the Trade and Tariff Act of 1984 if such entry were made on November 14, 1984,

shall be liquidated or reliquidated as though such entry had been made on November 14, 1984.

(b) APPLICABLE DATE.—For purposes of this section—

(1) The term "applicable date" means—

(A) with respect to any entry for which the amendment described in subsection (a)(2) is any amendment made by section 118 of the Trade and Tariff Act of 1984, June 1, 1982;

(B) with respect to any entry for which the amendment described in subsection (a)(2) is any amendment made by section 112, 115, or 179 of the Trade and Tariff Act of 1984, June 30, 1983; and

(C) with respect to any entry for which the amendment described in subsection (a)(2) is the amendment made by section 167 of the Trade and Tariff Act of 1984, October 30, 1983.

(2) The term "entry" includes any withdrawal from warehouse.

SEC. 1893. TECHNICAL AMENDMENTS RELATING TO CUSTOMS USER FEES.

(a) SCHEDULE OF FEES.—

(1) Subsection (a) of section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(a)) is amended—

(A) by striking out "Subject to the limitation in subsection (b)(2), for" in paragraph (2) and inserting in lieu thereof "For",

(B) by adding at the end thereof the following new paragraph:

"(8) For the arrival of a barge or other bulk carrier from Canada or Mexico, $100."

(2) Paragraph (3) of section 13031(a) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(a)(3)) is amended to read as follows:

"(3) For the arrival of each railroad car carrying passengers or commercial freight, $7.50."

(b) LIMITATIONS ON FEES.—

(1) Subsection (b) of section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(b)) is amended by adding at the end thereof the following new paragraphs:

"(4) No fee may be charged under subsection (a)(5) with respect to the arrival of any passenger—

"(A) who is in transit to a destination outside the customs territory of the United States, and

"(B) for whom customs inspectional services are not provided.

"(5) No fee may be charged under subsection (a)(1) for the arrival of—

"(A) a vessel during a calendar year after a total of $5,955 in fees charged under paragraph (1) or (8) of subsection (a) has been paid to the Secretary of the Treasury for the provision of customs services for all arrivals of such vessel during such calendar year,

"(B) any vessel which, at the time of the arrival, is being used solely as a tugboat, or

"(C) any barge or other bulk carrier from Canada or Mexico.

"(6) No fee may be charged under subsection (a)(8) for the arrival of a barge or other bulk carrier during a calendar year after a total of $1,500 in fees charged under paragraph (1) or (8) of subsection (a) has been paid to the Secretary of the Treasury for the provision of customs services for all arrivals of such barge or other bulk carrier during such calendar year.

"(7) No fee may be charged under paragraphs (2), (3), or (4) of subsection (a) for the arrival of any—

"(A) commercial truck,

"(B) railroad car, or

"(C) private vessel,

that is being transported, at the time of the arrival, by any vessel that is not a ferry."

(2) Subparagraph (A) of section 13031(b)(1) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(b)(1)(A)) is amended to read as follows:

"(A) the arrival of any passenger whose journey—

"(i) originated in—

"(I) Canada,

"(II) Mexico,

"(III) a territory or possession of the United States, or

"(IV) any adjacent island (within the meaning of section 101(b)(5) of the Immigration and Nationality Act (8 U.S.C. 1101(b)(5)), or

"(ii) originated in the United States and was limited to—

"(I) Canada,

"(II) Mexico,

"(III) territories and possessions of the United States, and

"(IV) such adjacent islands;".

(3) Paragraph (1) of section 13031(b) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(b)(1)) is amended—

(A) by striking out the period at the end of subparagraph (B) and inserting in lieu thereof "; or ", and

(B) by adding at the end thereof the following new subparagraph:

"(C) the arrival of any ferry."

(4) Subsection (c) of section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(c)) is amended—

(A) by amending paragraph (1) to read as follows:

"(1) The term 'ferry' means any vessel which is being used—

"(A) to provide transportation only between places that are no more than 300 miles apart, and

"(B) to transport only—

"(i) passengers, or

"(ii) vehicles, or railroad cars, which are being used, or have been used, in transporting passengers or goods.", and

(B) by adding at the end thereof the following new paragraph:

"(5) The term 'barge or other bulk carrier' means any vessel which—

"(A) is not self-propelled, or

"(B) transports fungible goods that are not packaged in any form."

(c) SPECIAL PROVISIONS RELATING TO CUSTOMS BROKER PERMITS.—

(1) Subsection (d) of section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(d)) is amended by adding at the end thereof the following new paragraph:

"(4)(A) Notice of the date on which payment of the fee imposed by subsection (a)(7) is due shall be published by the Secretary of the Treasury in the Federal Register by no later than the date that is 60 days before such due date.

"(B) A customs broker permit may be revoked or suspended for nonpayment of the fee imposed by subsection (a)(7) only if

notice of the date on which payment of such fee is due was published in the Federal Register at least 60 days before such due date.

"(C) The customs broker's license issued under section 641(b) of the Tariff Act of 1930 (19 U.S.C. 1641(b)) may not be revoked or suspended merely by reason of nonpayment of the fee imposed under subsection (a)(7)."

(2) Notwithstanding section 13031(a)(7) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(a)(7)), the fee imposed by section 13031(a) of such Act with respect to each customs broker permit held by an individual, partnership, association, or corporate customs broker for calendar year 1986 is $62.50.

(3)(A) The Secretary of the Treasury shall reinstate any customs broker's license or customs broker permit issued under subsection (b) or (c) of section 641 of the Tariff Act of 1930 (19 U.S.C. 1641) that was suspended or revoked on or before the date of enactment of this Act solely by reason of nonpayment of the fee imposed by section 13031(a)(7) of the Consolidated Omnibus Budget Reconciliation Act of 1985.

(B) Notwithstanding any other provision of law, the Secretary of the Treasury may not suspend or revoke any customs broker permit issued under section 641(c) of the Tariff Act of 1930 (19 U.S.C. 1641(c)) solely by reason of nonpayment of the fee imposed by section 13031(a)(7) of the Consolidated Omnibus Budget Reconciliation Act of 1985 before the date that is 60 days after the date of enactment of this Act.

(d) Provision of Foreign Pre-Clearance Services.—

(1) Paragraph (1) of section 13031(e) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(e)(1)) is amended to read as follows:

"(1) Notwithstanding section 451 of the Tariff Act of 1930 (19 U.S.C. 1451) or any other provision of law (other than paragraph (2)), the customs services required to be provided to passengers upon arrival in the United States shall be adequately provided in connection with scheduled airline flights at customs serviced airports when needed and at no cost (other than the fees imposed under subsection (a)) to airlines and airline passengers."

(2) Subsection (e) of section 13031 of such Act is amended by—

(A) striking out "This subsection" in paragraph (2) and inserting in lieu thereof "Paragraph (1)", and

(B) by adding at the end thereof the following new paragraph:

"(3) Notwithstanding section 451 of the Tariff Act of 1930 (19 U.S.C. 1451) or any other provision of law—

"(A) the customs services required to be provided to passengers upon arrival in the United States shall be adequately provided in connection with scheduled airline flights when needed at places located outside the customs territory of the United States at which a customs officer is stationed for the purpose of providing such customs services, and

"(B) other than the fees imposed under subsection (a), the airlines and airline passengers shall not be required to reimburse the Secretary of the Treasury for the costs of providing overtime customs inspectional services at such places."

(e) Regulations on Remittance of Fees.—Subsection (g) of section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (19 U.S.C. 58c(g)) is amended by adding at the end thereof the following new sentence: "Regulations issued by the Secretary of the Treasury under this subsection with respect to the collection of the fees charged under subsection (a)(5) and the remittance of such fees to the Treasury of the United States shall be consistent with the regulations issued by the Secretary of the Treasury for the collection and remittance of the taxes imposed by subchapter C of chapter 33 of the Internal Revenue Code of 1954, but only to the extent the regulations issued with respect to such taxes do not conflict with the provisions of this section."

(f) Reinstating Limit on Charges for Other Inspection Services.—Section 53 of the Airport and Airway Development Act of 1970 (49 U.S.C. 1741), as amended by section 13031(h)(2) of the Consolidated Omnibus Budget Reconciliation Act of 1985, is further amended by adding at the end thereof the following new subsection:

"(e)(1) The cost of any inspection or quarantine service which is required to be performed by the Federal Government or any agency thereof at airports of entry or other places of inspection as a consequence of the operation of aircraft, and which is performed during regularly established hours of service on Sundays or holidays shall be reimbursed by the owners or operators of such aircraft only to the same extent as if such service had been performed during regularly established hours of service on weekdays. Notwithstanding any other provision of law, administrative overhead costs associated with any inspection or quarantine service required to be performed by the United States Government, or any agency thereof, at airports of entry as a result of the operation of aircraft, shall not be assessed against the owners or operators thereof.

"(2) Nothing in this subsection may be construed as requiring reimbursement for costs incurred by the Secretary of the Treasury in providing customs services described in section 13031(e)(1) of the Consolidated Omnibus Budget Reconciliation Act of 1985."

(g) Effective Date; Refunds.—

(1) The amendments made by this section shall apply with respect to services rendered after the date that is 15 days after the date of enactment of this Act.

(2) Upon written request filed by any person with the Secretary of the Treasury (hereafter in this subsection referred to as the "Secretary") before the date that is 90 days after the date of enactment of this Act which is accompanied by such documentation establishing proof of payment as the Secretary may require, the Secretary shall refund (out of funds in the Treasury of the United States not otherwise appropriated) to such person an amount equal to the excess of—

(A) the amount of fees imposed by section 13031 of the Consolidated Omnibus Budget Reconciliation Act of 1985

that were paid by such person to the Secretary with respect to customs services provided—

(i) after July 6, 1986, and

(ii) on or before the date that is 15 days after the date of enactment of this Act, over

(B) the amount of fees such person would have been required to pay to the Secretary by reason of such section with respect to such services if the amendments made by subsections (a)(1) and (b) applied with respect to such services.

(3) If the customs broker permit fee paid by any person for calendar year 1986 under section 13031(a)(7) of the Consolidated Omnibus Budget Reconciliation Act of 1985 exceeds $62.50, the Secretary shall either—

(A) refund (out of funds in the Treasury of the United States not otherwise appropriated) to such person the amount of the excess, or

(B) if requested by such person, credit the amount of the excess to the fee due under such section 13031(a)(7) with respect to such permit for calendar year 1987.

SEC. 1894. FOREIGN TRADE ZONES.

Section 3 of the Act of June 18, 1934 (48 Stat. 999, chapter 590; 19 U.S.C. 81c) is amended by adding at the end thereof the following new subsection:

"(c) Notwithstanding the provisions of the fifth proviso of subsection (a), any article (within the meaning of section 5002(a)(14) of the Internal Revenue Code of 1986) may be manufactured or produced from domestic denatured distilled spirits, and articles thereof, in a zone."

Subtitle C—Miscellaneous

CHAPTER 1—AMENDMENTS RELATED TO THE CONSOLIDATED OMNIBUS BUDGET RECONCILIATION ACT OF 1985

SEC. 1895. COBRA TECHNICAL CORRECTIONS RELATING TO SOCIAL SECURITY ACT PROGRAMS.

(a) AMENDMENT RELATING TO THE OASDI PROGRAM.—Section 12108(b) of the Consolidated Omnibus Budget Reconciliation Act of 1985 is amended by striking out "1985" and inserting in lieu thereof "1986".

(b) AMENDMENTS RELATING TO THE MEDICARE PROGRAM.—

(1) INDIRECT MEDICAL EDUCATION.—(A) Paragraph (2)(C)(i) of subsection (d) of section 1886 of the Social Security Act (42 U.S.C. 1395ww) is amended by striking out "(taking into account, for discharges occurring after September 30, 1986, the amendments made by section 9104(a) of the Medicare and Medicaid Budget Reconciliation Amendments of 1985)".

(B) Paragraph (3)(A) of such subsection is amended by adding at the end the following: "If the formula under paragraph (5)(B) for determining payments for the indirect costs of medical *education is changed for any fiscal year, the Secretary shall readjust the standardized amounts previously determined for each hospital to take into account the changes in that formula.".*

(C) Clause (ii) of paragraph (3)(C) of such subsection is amended to read as follows:

"(ii) REDUCING FOR SAVINGS FROM AMENDMENT TO INDIRECT TEACHING ADJUSTMENT FOR DISCHARGES AFTER SEPTEMBER 30, 1986.—The Secretary shall further reduce each of the average standardized amounts by a proportion equal to the proportion (estimated by the Secretary) of the amount of payments under this subsection based on DRG prospective payment amounts which is the difference between—

"(I) the sum of the additional payment amounts under paragraph (5)(B) (relating to indirect costs of medical education) if the indirect teaching adjustment factor were equal to 1.159r (as 'r' is defined in paragraph (5)(B)(ii)), and

"(II) that sum using the factor specified in paragraph (5)(B)(ii)(II).".

(D)(i) Except as provided in clause (ii), the amendments made by this paragraph apply to discharges occurring on or after October 1, 1986.

(ii) The amendments made by this paragraph shall not be first applied to discharges occurring as of a date unless, for discharges occurring on that date, the amendments made by section 9105(a) of the Consolidated Omnibus Budget Reconcilation Act of 1985 (incorporating the amendments made by paragraph (2) of this subsection) are also being applied.

(2) DISPROPORTIONATE SHARE.—(A) Paragraph (2)(C) of subsection (d) of section 1886 of the Social Security Act (42 U.S.C. 1395ww), as amended by section 9105(b) of the Consolidated Omnibus Budget Reconciliation Act of 1985 (in this section referred to as "COBRA") is amended—

(i) by adding "and" at the end of clause (ii),

(ii) by striking out ", and" at the end of clause (iii) and inserting in lieu thereof a period, and

(iii) by striking out clause (iv).

(B) Paragraph (3)(C) of such subsection is amended by adding at the end the following:

"(iii) REDUCING FOR DISPROPORTIONATE SHARE PAYMENTS.—The Secretary shall further reduce each of the average standardized amounts by reducing the standardized amount for each hospital (as previously determined without regard to this clause) by a proportion equal to the proportion (established by the Secretary) of the amount of payments under this subsection based on DRG prospective payment amounts which are additional payments described in paragraph (5)(F) (relating to disproportionate share payments) for subsection (d) hospitals.".

(C) Paragraph (5)(F)(vi)(I) of such subsection is amended—

(i) by striking out "supplementary" and inserting in lieu thereof "supplemental", and

(ii) by striking out "fiscal year" and inserting in lieu thereof "period".

(D) The amendments made by subparagraph (C) apply to discharges occurring on or after May 1, 1986, and the amendments made by subparagraphs (A) and (B) apply to discharges occurring on or after October 1, 1986.

(3) ALIGNMENT CORRECTION.—Subparagraph (B) of section 1886(g)(2) of the Social Security Act (as added by section 9107(a)(1)(C) of the Consolidated Omnibus Budget Reconciliation Act of 1985) is amended by moving its alignment (and the alignment of each of its clauses) two additional ems to the left.

(4) EMERGENCY CARE REQUIREMENT.—Section 1867(e)(3) of the Social Security Act (42 U.S.C. 1395dd(e)(3)), as inserted by section 9121(b) of COBRA, is amended by striking out "and has, under the agreement, obligated itself to comply with the requirements of this section".

(5) REDESIGNATING OVERLAPPING PROVISIONS.—Paragraph (1) of section 1866(a) of the Social Security Act (42 U.S.C. 1395cc(a)) is amended—

(A) by striking out "and" inserted at the end of subparagraph (I) by section 9122(a)(2) of COBRA,

(B) by striking out the period at the end of subparagraph (J) and inserting in lieu thereof ", and", and

(C) by redesignating the subparagraph (I) inserted by section 9403(b) of COBRA as subparagraph (K) and transferring and inserting such subparagraph after subparagraph (J).

(6) CHAMPUS.—Section 9122(b) of COBRA is amended by striking out "to agreements entered into or renewed on or after the date of the enactment of this Act, but shall apply only".

(7) SKILLED NURSING FACILITY PAYMENTS.—(A) Section 1888(d)(1) of the Social Security Act (42 U.S.C. 1395yy(d)(1)), as added by section 9126(a) of COBRA, is amended by striking out "fiscal year" each place it appears and inserting in lieu thereof "cost reporting period".

(B) Section 1888(d)(4) of the Social Security Act is amended—

(i) in the first sentence, by striking out "each fiscal year" and inserting in lieu thereof "cost reporting periods beginning in a fiscal year", and

(ii) in the second sentence, by striking out "fiscal year" and all that follows up to the period and inserting in lieu thereof "cost reporting period no later than 30 days before the beginning of that period".

(C) Section 9126(d)(1) of COBRA is amended by striking out "fiscal years" and inserting in lieu thereof "cost reporting periods".

(D) The amendments made by subparagraphs (A) and (B) apply to cost reporting periods beginning on or after October 1, 1986.

(8) PROPAC.—Section 9127(b) of COBRA is amended by inserting ", except that the Director may provide initially for such terms as will insure that (on a continuing basis) the terms of no more than eight members will expire in any one year" after "years".

(9) Direct medical education.—Section 1886(h) of the Social Security Act (42 U.S.C. 1395ww(h)), added by 9202(a) of COBRA, is amended—

(A) in paragraph (2)(C), by striking out "paragraph (B)" and inserting in lieu thereof "subparagraph (B)",

(B) in the matter preceding subclause (I) of paragraph (4)(E)(ii), by inserting "but before July 1, 1987," after "1986,",

(C) by redesignating subparagraph (E) of paragraph (4) as subparagraph (D), and

(D) in paragraph (5)(B), by striking out "As used in this paragraph, the" and inserting in lieu therof "The".

(10) Citation correction.—Section 9202(j) of COBRA is amended by inserting "or section 402 of the Social Security Amendments of 1967" after "section 1886(c) of the Social Security Act".

(11) HMO/CMP rates.—(A) The matter in section 1876(a)(1)(A) of the Social Security Act (42 U.S.C. 1395mm(a)(1)(A)) preceding clause (i), as amended by section 9211(d) of COBRA, is amended by striking out "publish" and inserting in lieu therof "announce (in a manner intended to provide notice to interested parties)".

(B) The amendment made by subparagraph (A) shall apply to determinations of per capita payment rates for 1987 and subsequent years.

(12) Indentation.—Section 1837(i)(1) of the Social Security Act (42 U.S.C. 1395p(i)(1)), as amended by section 9219(a)(2)(A) of COBRA, is amended by moving the alignment of subparagraph (A) two additional ems to the left so as to align its left margin with the left margins of subparagraphs (B) and (C) of such section.

(13) Access demonstration project.—Section 9221(a) of COBRA is amended by striking out "September 30, 1986" and inserting in lieu thereof "July 31, 1987".

(14) Physician payment.—(A) Section 1842(b)(4)(C) of the Social Security Act (42 U.S.C. 1395u(b)(4)(C)), as amended by section 9301(b)(1)(C) of COBRA, is amended—

(i) by striking out clause (ii), and

(ii) by striking out "(i)" in clause (i).

(B) Section 9301(c)(5) of COBRA is amended by striking out "1842(b)(7)" and inserting in lieu thereof "1842(h)(7)".

(15) Redundant words.—Section 1842(h) of the Social Security Act (42 U.S.C. 1395u(h)), as amended by section 9301(c) of COBRA, is amended—

(A) in paragraph (5), as redesignated by section 9301(c)(3)(D) of COBRA, by striking out "such" each place it appears, and

(B) in paragraph (6), as so redesignated, by striking out "the the" and inserting in lieu thereof "the".

(16) Assistants at surgery.—(A) Section 1842(k) of the Social Security Act (42 U.S.C. 1395u(k)), added by section 9307(c) of COBRA, is amended by inserting "presents or causes to be presented a claim or" after "willfully" each place it appears.

(B) The amendment made by subparagraph (A) shall apply to claims presented after the date of the enactment of this Act.

(C) For purposes of section 1862(a)(15) of the Social Security Act (42 U.S.C. 1395y(a)(15)), added by section 9307(a)(3) of COBRA, and for surgical procedures performed during the period beginning on April 1, 1986, and ending on December 15, 1986, a carrier is deemed to have approved the use of an assistant in a surgical procedure, before the surgery is performed, based on the existence of a complicating medical condition if the carrier determines after the surgery is performed that the use of the assistant in the procedure was appropriate based on the existence of a complicating medical condition before or during the surgery.

(17) CITATION.—Section 1164(b)(4)(B) of the Social Security Act (42 U.S.C. 1320c-13(b)(4)(B)), as added by section 9401(b) of COBRA, is amended by striking out "paragraphs" and inserting in lieu thereof "subparagraphs".

(18) MEDICARE TAX ON STATE AND LOCAL EMPLOYEES.—(A) Section 3121(u)(2)(B)(ii) of the Internal Revenue Code of 1954, as added by section 13205(a)(1) of COBRA, is amended—

(i) by striking out "or" at the end of subclause (III),

(ii) by striking out the period at the end of subclause (IV) and inserting in lieu thereof ", or", and

(iii) by adding at the end the following:

"(V) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $100."

(B) Section 210(p)(2) of the Social Security Act (42 U.S.C. 410(p)(2)), as added by section 13205(b)(1) of COBRA, is amended—

(i) by striking out "or" at the end of subparagraph (C),

(ii) by striking out the period at the end of subparagraph (D) and inserting in lieu thereof ", or", and

(iii) by adding at the end the following:

"(E) by an election official or election worker if the remuneration paid in a calendar year for such service is less than $100."

(C) The amendments made by this paragraph shall apply to services performed after March 31, 1986.

(19) PUNCTUATION.—Section 210(p)(4)(B) of the Social Security Act (42 U.S.C. 410(p)(4)(B)), as amended by section 13205(b)(1) of COBRA, is amended by striking out any quotation marks that appear before "(A)".

(c) AMENDMENTS RELATING TO THE MEDICAID PROGRAM.—

(1) EXTRA WORD.—Section 1902(a)(13)(D) of the Social Security Act (42 U.S.C. 1396a(a)(13)(D)), as inserted by section 9505(c)(1)(C) of COBRA and as amended and redesignated by paragraphs (2) and (3) of section 9509(a) of COBRA, is amended by adding "and" at the end.

(2) CAPITALIZATION.—Section 1903(m)(2)(F) of the Social Security Act (42 U.S.C. 1396b(m)(2)(F)), as amended by section 9517(a)(2)(A) of COBRA, is amended by striking out "in the case" and inserting in lieu thereof "In the case".

(3) CASE-MANAGEMENT SERVICES.—(A) Section 1905(a) of the Social Security Act (42 U.S.C. 1395d(a)) is amended—

(i) by striking out "and" at the end of paragraph (18),

(ii) by redesignating paragraph (19) as paragraph (20), and

(iii) by inserting after paragraph (18) the following new paragraph:

"(19) case-management services (as defined in section 1915(g)(2)); and".

(B) Section 1902(j) of the Social Security Act (42 U.S.C. 1396a(j)), as amended by section 9505(d)(1) of COBRA, is amended by striking out "(19)" and inserting in lieu thereof "(20)".

(C) Section 1902(a)(10)(C)(iv) of the Social Security Act (42 U.S.C. 1396a(a)(10)(C)(iv)), as amended by section 9505(d)(2) of COBRA, is amended by striking out "through (18)" and inserting in lieu thereof "through (19)".

(4) HEALTH INSURING ORGANIZATIONS.—Section 9517(c)(2) of COBRA is amended—

(A) in subparagraph (A), by adding at the end the following "For purposes of this paragraph, a health insuring organization is not considered to be operational until the date on which it first enrolls patients.";

(B) in subparagraph (B), by striking out "(iv)" and inserting in lieu thereof "(vi)"; and

(C) by adding at the end the following new subparagraph:

"(C) In the case of the Hartford Health Network, Inc., clauses (ii) and (vi) of section 1903(m)(2)(A) of the Social Security Act shall not apply during the period for which a waiver by the Secretary of Health and Human Services, under section 1915(b) of such Act, of certain requirements of section 1902 of such Act is in effect (pursuant to a request for a waiver under section 1915(b) of such Act submitted before January 1, 1986)."

(5) REFERENCES TO OTHER PROVISIONS.—Section 1920(a) of the Social Security Act (42 U.S.C. 1396s(a)), as added by section 9526 of COBRA, is amended—

(A) in paragraph (1)—

(i) by redesignating subparagraphs (B) and (C) as subparagraphs (C) and (D), respectively, and

(ii) by inserting after "—(A)" the following: "Section 402(a)(32) of this Act (relating to individuals who are deemed recipients of aid but for whom a payment is not made).

"(B)";

(B) in paragraph (2)—

(i) by inserting "(A)" after the dash, and

(ii) by adding at the end the following new subparagraph:

"(B) Section 1634(b) of this Act (relating to preservation of benefit status for disabled widows and widowers who lost SSI benefits because of 1983 changes in actuarial reduction formula)."; and

(C) in paragraph (3), by striking out "Section 473(b)" and inserting in lieu thereof "Sections 472(h) and 473(b)".

(6) Reference correction.—Section 9528(a) of COBRA is amended by striking out "1101(a)(8)(P)" and inserting in lieu thereof "1101(a)(8)(B)".

(7) Indentation.—Section 1902(a)(10)(A)(ii)), of the Social Security Act (42 U.S.C. 1396a(a)(10)(A)(ii)), as amended by sections 9505(b)(2) and 9529(b)(1) of COBRA, is amended—

(A) by indenting subclause (VII) two additional ems so as to align its left margin with the left margins of subclauses (I) through (VI) of such section, and

(B) by indenting subclause (VIII) (and each of its subdivisions) four additional ems so as to align its left margin with the left margins of subclauses (I) through (VI) of such section.

(d) Amendments Relating to Continuation of Employer-Based Health Insurance Coverage.—

(1) Effect of modifications to plan coverage provisions.—

(A) IRC amendment.—Subparagraph (A) of section 162(k)(2) (relating to type of benefit coverage) is amended by adding at the end the following: "If coverage under the plan is modified for any group of similarly situated beneficiaries, the coverage shall also be modified in the same manner for all individuals who are qualified beneficiaries under the plan pursuant to this subsection in connection with such group."

(B) ERISA amendment.—Paragraph (1) of section 602 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1162(1); 100 Stat. 228) is amended by adding at the end the following: "If coverage is modified under the plan for any group of similarly situated beneficiaries, such coverage shall also be modified in the same manner for all individuals who are qualified beneficiaries under the plan pursuant to this part in connection with such group."

(C) PHSA amendment.—Paragraph (1) of section 2202 of the Public Health Service Act is amended by adding at the end the following: "If coverage is modified under the plan for any group of similarly situated beneficiaries, such coverage shall also be modified in the same manner for all individuals who are qualified beneficiaries under the plan pursuant to this part in connection with such group."

(2) Maximum required period of continuation coverage.—

(A) IRC amendment.—Clause (i) of section 162(k)(2)(B) (relating to maximum period of coverage) is amended to read as follows:

"(i) Maximum required period—

"(I) General rule for terminations and reduced hours.—In the case of a qualifying event described in paragraph (3)(B), except as provided in subclause (II), the date which is 18 months after the date of the qualifying event.

"(II) Special rule for multiple qualifying events.—If a qualifying event occurs during the 18 months after the date of a qualifying event de-

scribed in paragraph (3)(B), the date which is 36 months after the date of the qualifying event described in paragraph (3)(B).

"(III) General rule for other qualifying events.—In the case of a qualifying event not described in paragraph (3)(B), the date which is 36 months after the date of the qualifying event."

(B) ERISA amendment.—Subparagraph (A) of section 602(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1162(2); 100 Stat. 228) is amended to read as follows:

"(A) Maximum required period.—

"(i) General rule for terminations and reduced hours.—In the case of a qualifying event described in section 630(2), except as provided in clause (ii), the date which is 18 months after the date of the qualifying event.

"(ii) Special rule for multiple qualifying events.—If a qualifying event occurs during the 18 months after the date of a qualifying event described in section 603(2), the date which is 36 months after the date of the qualifying event described in section 603(2).

"(iii) General rule for other qualifying events.—In the case of a qualifying event not described in section 603(2), the date which is 36 months after the date of the qualifying event."

(C) PHSA amendment.—Subparagraph (A) of section 2202(2) of the Public Health Service Act is amended to read as follows:

"(A) Maximum required period.—

"(i) General rule for terminations and reduced hours.—In the case of a qualifying event described in section 2203(2), except as provided in clause (ii), the date which is 18 months after the date of the qualifying event.

"(ii) Special rule for multiple qualifying events.—If a qualifying event occurs during the 18 months after the date of a qualifying event described in section 2203(2), the date which is 36 months after the date of the qualifying event described in section 2203(2).

"(iii) General rule for other qualifying events.—In the case of a qualifying event not described in section 2203(2), the date which is 36 months after the date of the qualifying event."

(3) Grace period for payment of premiums.—

(A) IRC amendment.—Clause (iii) of section 162(k)(2)(B) (relating to failure to pay premium) is amended by adding at the end the following: "The payment of any premium (other than any payment referred to in the last sentence of subparagraph (C)) shall be considered to be timely if made within 30 days after the date due or within such longer period as applies to or under the plan.".

(B) ERISA AMENDMENT.—Subparagraph (C) of section 602(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1162(2)(C); 100 Stat. 228) is amended by adding at the end the following: "The payment of any premium (other than any payment referred to in the last sentence of paragraph (3)) shall be considered to be timely if made within 30 days after the date due or within such longer period as applies to or under the plan."

(C) PHSA AMENDMENT.—Subparagraph (C) of section 2202(2) of the Public Health Service Act is amended by adding at the end the following: "The payment of any premium (other than any payment referred to in the last sentence of paragraph (3)) shall be considered to be timely if made within 30 days after the date due or within such longer period as applies to or under the plan."

(4) TERMINATION OF CONTINUATION COVERAGE UPON COVERAGE BY OTHER GROUP HEALTH PLAN RATHER THAN UPON REEMPLOYMENT OR REMARRIAGE.—

(A) IRC AMENDMENT.—Subparagraph (B) of section 162(k)(2) (relating to period of coverage) is amended—

(i) by striking out clause (v); and

(ii) by striking out subclause (I) of clause (iv) and inserting in lieu thereof the following:

"(I) covered under any other group health plan (as an employee or otherwise), or";

and

(iii) by striking out the heading for clause (iv) and inserting in lieu thereof the following: "GROUP HEALTH PLAN COVERAGE OR MEDICARE ELIGIBILITY.—".

(B) ERISA AMENDMENT.—Section 602(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1162(2); 100 Stat. 228) is amended—

(i) by striking out subparagraph (E);

(ii) by striking out clause (i) of subparagraph (D) and inserting in lieu thereof the following:

"(i) covered under any other group health plan (as an employee or otherwise), or"; and

(iii) by striking out the heading for subparagraph (D) and inserting in lieu thereof the following: "GROUP HEALTH PLAN COVERAGE OR MEDICARE ELIGIBILITY.—".

(C) PHSA AMENDMENT.—Section 2202(2) of the Public Health Service Act is amended—

(i) by striking out subparagraph (E);

(ii) by striking out clause (i) of subparagraph (D) and inserting in lieu thereof the following:

"(i) covered under any other group health plan (as an employee or otherwise), or"; and

(iii) by striking out the heading for subparagraph (D) and inserting in lieu thereof the following: "GROUP HEALTH PLAN COVERAGE OR MEDICARE ELIGIBILITY.—".

(5) CLARIFICATION RELATING TO ELECTION BY BENEFICIARIES.—

(A) IRC AMENDMENT.—*Subparagraph (B) of section 162(k)(2) (relating to effect of election on other beneficiaries) is amended—*

(i) by inserting "of continuation coverage" after "any election"; and

(ii) by adding at the end the following: "If there is a choice among types of coverage under the plan, each qualified beneficiary is entitled to make a separate selection among such types of coverage.".

(B) ERISA AMENDMENT.—*Section 605(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1162(2); 100 Stat. 230) is amended—*

(i) by inserting "of continuation coverage" after "any election"; and

(ii) by adding at the end the following: "If there is a choice among types of coverage under the plan, each qualified beneficiary is entitled to make a separate selection among such types of coverage.".

(C) PHSA AMENDMENT.—*Section 2205(2) of the Public Health Service Act is amended—*

(i) by inserting "of continuation coverage" after "any election"; and

(ii) by adding at the end the following: "If there is a choice among types of coverage under the plan, each qualified beneficiary is entitled to make a separate selection among such types of coverage.".

(6) NOTICE REQUIREMENT.—

(A) IRC AMENDMENT.—*Subparagraph (C) of section 162(k)(6) (relating to notice requirements) is amended by inserting "within 60 days after the date of the qualifying event" after "paragraph (3)".*

(B) ERISA AMENDMENT.—*Paragraph (3) of section 606 of the Employees Retirement Income Security Act of 1974 (29 U.S.C. 1166(3); 100 Stat. 230) is amended by inserting "within 60 days after the date of the qualifying event"; after "section 603".*

(C) PHSA AMENDMENT.—*Paragraph (3) of section 2206 of the Public Health Service Act is amended by inserting "within 60 days after the date of the qualifying event" after "section 603".*

(D) EFFECTIVE DATE.—*The amendments made by this paragraph shall only apply with respect to qualifying events occurring after the date of the enactment of this Act.*

(7) NONRESIDENT ALIENS.—*Subparagraph (B) of section 162(k)(7) (relating to qualified beneficiaries) is amended by adding at the end thereof the following new clause:*

"(iii) EXCEPTION FOR NONRESIDENT ALIENS.—*Notwithstanding clauses (i) and (ii), the term "qualified beneficiary' does not include an individual whose status as a covered employee is attributable to a period in which such individual was a nonresident alien who received no earned income (within the meaning of section 911(d)(2)) from the employer which constituted income from sources within the United States (within*

the meaning of section 861(a)(3)). If an individual is not a qualified beneficiary pursuant to the previous sentence, a spouse or dependent child of such individual shall not be considered a qualified beneficiary by virtue of the relationship to the individual.".

(8) DEFINITION OF GROUP HEALTH PLAN FOR ERISA.—Paragraph (1) of section 607 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1167(1); 100 Stat. 231) is amended to read as follows:

"(1) GROUP HEALTH PLAN.—The term 'group health plan' means an employee welfare benefit plan providing medical care (as defined in section 213(d) of the Internal Revenue Code of 1954) to participants or beneficiaries directly or through insurance, reimbursement, or otherwise.".

(9) AGGREGATION RULES FOR EMPLOYER FOR ERISA.—

(A) IN GENERAL.—Section 607 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1167; 100 Stat. 231) is amended by adding at the end the following new paragraph:

"(4) EMPLOYER.—Subsection (n) (relating to leased employees) and subsection (t) (relating to application of controlled group rules to certain employee benefits) of section 414 of the Internal Revenue Code of 1986 shall apply for purposes of this part in the same manner and to the same extent as such subsections apply for purposes of section 106 of such Code. Any regulations prescribed by the Secretary pursuant to the preceding sentence shall be consistent and coextensive with any regulations prescribed for similar purposes by the Secretary of the Treasury (or such Secretary's delegate) under such subsections.".

(B) EFFECTIVE DATE.—The amendment made by subparagraph (A) shall take effect in the same manner and to the same extent as the amendments made by subsections (e) and (i) of section 1151 of this Act.

(e) EFFECTIVE DATE.—Except as otherwise provided in this section, the amendments made by this section shall be effective as if included in the enactment of the Consolidated Omnibus Budget Reconciliation Act of 1985.

SEC. 1896. EXTENSION OF TIME FOR FILING FOR CREDIT OR REFUND WITH RESPECT TO CERTAIN CHANGES INVOLVING INSOLVENT FARMERS.

Section 13208 of the Consolidated Omnibus Budget Reconciliation Act of 1985 (relating to certain insolvent taxpayers allowed to reduce capital gains preference item for purposes of the individual minimum tax) is amended by adding at the end thereof the following new subsection:

"(c) STATUTE OF LIMITATIONS.—If refund or credit of any overpayment of tax resulting from the application of the amendment made by subsection (a) is prevented at any time before the close of the date which is 1 year after the date of the enactment of this Act, by the operation of any law or rule of law (including res judicata), refund or credit of such overpayment (to the extent attributable to the application of such amendment) may, nevertheless, be made or allowed if claim therefor is filed on or before the close of such 1-year period."

SEC. 1897. CORRECTION OF CLERICAL ERROR IN AMENDMENTS TO COAL TAX.

(a) IN GENERAL.—Subsection (b) of section 4121 (relating to excise tax on coal) is amended by striking out ", in the case of sales during any calendar year beginning after December 31, 1985".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall take effect as if included in the amendment made by section 13203 of the Consolidated Omnibus Budget Reconciliation Act of 1985.

CHAPTER 2—AMENDMENTS RELATED TO THE RETIREMENT EQUITY ACT OF 1984

SEC. 1898. TECHNICAL CORRECTIONS TO THE RETIREMENT EQUITY ACT OF 1984.

(a) AMENDMENTS RELATED TO SECTIONS 102 AND 202 OF THE ACT.—

(1) TREATMENT OF CLASS-YEAR PLANS.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Paragraph (4) of section 411(d) (relating to class-year plans) is amended to read as follows:

"(4) CLASS-YEAR PLANS.—

"(A) IN GENERAL.—The requirements of subsection (a)(2) shall be treated as satisfied in the case of a class-year plan if such plan provides that 100 percent of each employee's right to or derived from the contributions of the employer on the employee's behalf with respect to any plan year is nonforfeitable not later than when such participant was performing services for the employer as of the close of each of 5 plan years (whether or not consecutive) after the plan year for which the contributions were made.

"(B) 5-YEAR BREAK IN SERVICE.—For purposes of subparagraph (A) if—

"(i) any contributions are made on behalf of a participant with respect to any plan year, and

"(ii) before such participant meets the requirements of subparagraph (A), such participant was not performing services for the employer as of the close of each of any 5 consecutive plan years after such plan year,

then the plan may provide that the participant forfeits any right to or derived from the contributions made with respect to such plan year.

"(C) CLASS-YEAR PLAN.—For purposes of this section, the term 'class-year plan' means a profit-sharing, stock bonus, or money purchase plan which provides for the separate nonforfeitability of employees' rights to or derived from the contributions for each plan year."

(B) AMENDMENT OF ERISA.—Paragraph (3) of section 203(c) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(3)(A) The requirements of subsection (a)(2) shall be treated as satisfied in the case of a class-year plan if such plan provides that 100 percent of each employee's right to or derived from the contributions of the employer on the employee's behalf with respect to any plan year is nonforfeitable not later than

when such participant was performing services for the employer as of the close of each of 5 plan years (whether or not consecutive) after the plan year for which the contributions were made.

"(B) For purposes of subparagraph (A) if—

"(i) any contributions are made on behalf of a participant with respect to any plan year, and

"(ii) before such participant meets the requirements of subparagraph (A), such participant was not performing services for the employer as of the close of each of any 5 consecutive plan years after such plan year,

then the plan may provide that the participant forfeits any right to or derived from the contributions made with respect to such plan year.

"(C) For purposes of this part, the term 'class year plan' means a profit-sharing, stock bonus, or money purchase plan which provides for the separate nonforfeitability of employees' rights to or derived from the contributions for each plan year."

(C) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to contributions made for plan years beginning after the date of the enactment of this Act; except that, in the case of a plan described in section 302(b) of the Retirement Equity Act of 1984, such amendments shall not apply to any plan year to which the amendments made by such Act do not apply by reason of such section 302(b).

(2) RULES RELATING TO LUMP SUM TREATMENT.—Subsection (e) of section 402 (relating to tax on lump sum distributions) is amended by adding at the end thereof the following new paragraph:

"(6) TREATMENT OF POTENTIAL FUTURE VESTING.—

"(A) IN GENERAL.—For purposes of determining whether any distribution which becomes payable to the recipient on account of the employee's separation from service is a lump sum distribution, the balance to the credit of the employee shall be determined without regard to any increase in vesting which may occur if the employee is re-employed by the employer.

"(B) RECAPTURE IN CERTAIN CASES.—If—

"(i) an amount is treated as a lump sum distribution by reason of subparagraph (A),

"(ii) special lump sum treatment applies to such distribution,

"(iii) the employee is subsequently re-employed by the employer; and

"(iv) as a result of services performed after being so re-employed, there is an increase in the employee's vesting for benefits accrued before the separation referred to in subparagraph (A),

under regulations prescribed by the Secretary, the tax imposed by this chapter for the taxable year (in which the increase in vesting first occurs) shall be increased by the reduction in tax which resulted from the special lump sum treatment (and any election under paragraph (4)(B) shall not be taken into account for purposes of determining *whether the employee may make another election under paragraph (4)(B)).*

"(C) Special lump sum treatment.—For purposes of this paragraph, special lump sum treatment applies to any distribution if any portion of such distribution—

"(i) is taxed under this subsection by reason of an election under paragraph (4)(B), or

"(ii) is treated as long-term capital gain under subsection (a)(2) of this section or section 403(a)(2).

"(D) Vesting.—For purposes of this paragraph the term 'vesting' means the portion of the accrued benefits derived from employer contributions to which the participant has a nonforfeitable right."

(3) Rules relating to rollovers.—Paragraph (6) of section 402(a) (relating to special rollover rules) is amended by adding at the end thereof the following new subparagraph:

"(G) Treatment of potential future vesting.—

"(i) In general.—For purposes of paragraph (5), in determining whether any portion of a distribution on account of the employee's separation from service may be transferred in a transfer to which paragraph (5)(A) applies, the balance to the credit of the employee shall be determined without regard to any increase in vesting which may occur if the employee is re-employed by the employer.

"(ii) Treatment of subsequent distributions.—If—

"(I) any portion of a distribution is transferred in a transfer to which paragraph (5)(A) applies by reason of clause (i),

"(II) the employee is subsequently re-employed by the employer, and

"(III) as a result of service performed after being so re-employed, there is an increase in the employee's vesting for benefits accrued before the separation referred to in clause (i),

then the provisions of paragraph (5)(D)(iii) shall apply to any distribution from the plan after the distribution referred to in clause (i). The preceding sentence shall not apply if the distribution referred to in subclause (I) is made without the consent of the participant."

(4) Treatment of withdrawal of mandatory contributions.—

(A) Amendments of internal revenue code.—

(i) Clause (ii) of section 411(a)(3)(D) is amended by striking out the last sentence and inserting in lieu thereof the following: "The plan provision required under this clause may provide that such repayment must be made (I) in the case of a withdrawal on account of separation from service, before the earlier of 5 years after the first date on which the participant is subsequently re-employed by the employer, or the close of the first period of 5 consecutive 1-year breaks in service commencing after the withdrawal; or (II) in the

case of any other withdrawal, 5 years after the date of the withdrawal."

(ii) Subparagraph (C) of section 411(a)(7) is amended by striking out the last sentence and inserting in lieu thereof the following:

"The plan provision required under this subparagraph may provide that such repayment must be made (I) in the case of a withdrawal on account of separation from service, before the earlier of 5 years after the first date on which the participant is subsequently re-employed by the employer, or the close of the first period of 5 consecutive 1-year breaks in service commencing after the withdrawal; or (II) in the case of any other withdrawal, 5 years after the date of the withdrawal."

(B) AMENDMENTS OF ERISA.—

(i) Clause (ii) of section 203(a)(3)(D) of the Employee Retirement Income Security Act of 1974 is amended by striking out the last sentence and inserting in lieu thereof the following: "The plan provision required under this clause may provide that such repayment must be made (I) in the case of a withdrawal on account of separation from service, before the earlier of 5 years after the first date on which the participant is subsequently re-employed by the employer, or the close of the first period of 5 consecutive 1-year breaks in service commencing after the withdrawal; or (II) in the case of any other withdrawal, 5 years after the date of the withdrawal."

(ii) Subsection (e) of section 204 of the Employee Retirement Income Security Act of 1974 is amended by striking out the last sentence and inserting in lieu thereof the following:

"The plan provision required under this subsection may provide that such repayment must be made (A) in the case of a withdrawal on account of separation from service, before the earlier of 5 years after the first date on which the participant is subsequently re-employed by the employer, or the close of the first period of 5 consecutive 1-year breaks in service commencing after the withdrawal; or (B) in the case of any other withdrawal, 5 years after the date of the withdrawal."

(5) PARTICIPATION REQUIREMENTS UNDER SIMPLIFIED EMPLOYEE PENSIONS.—Effective with respect to plan years beginning after the date of the enactment of this Act, subparagraph (A) of section 408(k)(2) (relating to participation requirements) is amended by striking out "age 25" and inserting in lieu thereof "age 21".

(b) AMENDMENTS RELATED TO SECTIONS 103 AND 203 OF THE ACT.—

(1) CLARIFICATION OF QUALIFIED PRERETIREMENT SURVIVOR ANNUITY IN CASE OF TERMINATED VESTED PARTICIPANT.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Paragraph (1) of section 417(c) (defining qualified preretirement survivor annuity) is amended by adding at the end thereof the following new sentence:

"In the case of an individual who separated from service before the date of such individual's death, subparagraph (A)(ii)(I) shall not apply."

(B) AMENDMENT OF ERISA.—Paragraph (1) of section 205(e) of the Employee Retirement Income Security Act of 1974 (defining qualified preretirement survivor annuity) is amended by adding at the end thereof the following new sentence:

"In the case of an individual who separated from service before the date of such individual's death, subparagraph (A)(ii)(I) shall not apply."

(2) CLARIFICATION OF TRANSFEREE PLAN RULES.—

(A) AMENDMENTS OF INTERNAL REVENUE CODE.—

(i) Subclause (III) of section 401(a)(11)(B)(iii) (relating to plans to which requirements of joint and survivor annuity and preretirement survivor annuity apply) is amended by striking out "indirect transferee" and inserting in lieu thereof "indirect transferee (in a transfer after December 31, 1984)".

(ii) Subparagraph (B) of section 401(a)(11) is amended by adding at the end thereof the following new sentence:

"Clause (iii)(III) shall apply only with respect to the transferred assets (and income therefrom) if the plan separately accounts for such assets and any income therefrom."

(B) AMENDMENTS OF ERISA.—

(i) Clause (iii) of section 205(b)(1)(C) of the Employee Retirement Income Security Act of 1974 is amended by striking out "a transferee" and inserting in lieu thereof "a direct or indirect transferee (in a transfer after December 31, 1984)".

(ii) Paragraph (1) of section 205(b) of such Act is amended by adding at the end thereof the following new sentence:

"Clause (iii) of subparagraph (C) shall apply only with respect to the transferred assets (and income therefrom) if the plan separately accounts for such assets and any income therefrom."

(3) CLARIFICATION OF COORDINATION BETWEEN QUALIFIED JOINT AND SURVIVOR ANNUITY AND QUALIFIED PRERETIREMENT SURVIVOR ANNUITY.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Clause (i) of section 401(a)(11)(A) is amended by striking out "who retires under the plan" and inserting in lieu thereof "who does not die before the annuity starting date".

(B) AMENDMENT OF ERISA.—Paragraph (1) of section 205(a) of the Employee Retirement Income Security Act of 1974 is amended by striking out "who retires under the plan" and inserting in lieu thereof "who does not die before the annuity starting date".

(4) REQUIREMENT OF SPOUSAL CONSENT FOR USING PLAN ASSETS AS SECURITY FOR LOANS.—

(A) AMENDMENTS OF INTERNAL REVENUE CODE.—

(i) Subparagraph (B) of section 417(a)(1) is amended by striking out "paragraphs (2) and (3)" and inserting in lieu thereof "paragraphs (2), (3), and (4)".

(ii) Subsection (a) of section 417 is amended by redesignating paragraphs (4) and (5) as paragraphs (5) and (6), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) REQUIREMENT OF SPOUSAL CONSENT FOR USING PLAN ASSETS AS SECURITY FOR LOANS.—Each plan shall provide that, if section 401(a)(11) applies to a participant when part or all of the participant's accrued benefit is to be used as security for a loan, no portion of the participant's accrued benefit may be used as security for such loan unless—

"(A) the spouse of the participant (if any) consents in writing to such use during the 90-day period ending on the date on which the loan is to be so secured, and

"(B) requirements comparable to the requirements of paragraph (2) are met with respect to such consent."

(iii) Subsection (f) of section 417 is amended by redesignating paragraph (5) as paragraph (6) and by inserting after paragraph (4) the following new paragraph:

"(5) DISTRIBUTIONS BY REASON OF SECURITY INTERESTS.—If the use of any participant's accrued benefit (or any portion thereof) as security for a loan meets the requirements of subsection (a)(4), nothing in this section or section 411(a)(11) shall prevent any distribution required by reason of a failure to comply with the terms of such loan."

(B) AMENDMENT OF ERISA.—

(i) Subparagraph (B) of section 205(c)(1) of the Employee Retirement Income Security Act of 1974 is amended by striking out "paragraphs (2) and (3)" and inserting in lieu thereof "paragraphs (2), (3), and (4)".

(ii) Subsection (c) of section 205 of such Act is amended by redesignating paragraphs (4), (5), and (6) as paragraphs (5), (6), and (7), respectively, and by inserting after paragraph (3) the following new paragraph:

"(4) Each plan shall provide that, if this section applies to a participant when part or all of the participant's accrued benefit is to be used as security for a loan, no portion of the participant's accrued benefit may be used as security for such loan unless—

"(A) the spouse of the participant (if any) consents in writing to such use during the 90-day period ending on the date on which the loan is to be so secured, and

"(B) requirements comparable to the requirements of paragraph (2) are met with respect to such consent."

(iii) Section 205 of such Act is amended by redesignating subsection (j) as subsection (k) and by inserting after subsection (i) the following new subsection:

"(j) If the use of any participant's accrued benefit (or any portion thereof) as security for a loan meets the requirements of subsection (c)(4), nothing in this section shall prevent any distribution required by reason of a failure to comply with the terms of such loan."

(C) EFFECTIVE DATES.—

(i) The amendments made by this paragraph shall apply with respect to loans made after August 18, 1985.

(ii) In the case of any loan which was made on or before August 18, 1985, and which is secured by a portion of the participant's accrued benefit, nothing in the amendments made by sections 103 and 203 of the Retirement Equity Act of 1984 shall prevent any distribution required by reason of a failure to comply with the terms of such loan.

(iii) For purposes of this subparagraph, any loan which is revised, extended, renewed, or renegotiated after August 18, 1985, shall be treated as made after August 18, 1985.

(5) CLARIFICATION OF NOTICE REQUIREMENT FOR INDIVIDUALS WHO BECOME PARTICIPANTS AFTER AGE 35, ETC.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Subparagraph (B) of section 417(a)(3) (relating to plan to provide written explanations) is amended to read as follows:

"(B) EXPLANATION OF QUALIFIED PRERETIREMENT SURVIVOR ANNUITY.—

"(i) IN GENERAL.—Each plan shall provide to each participant, within the applicable period with respect to such participant (and consistent with such regulations as the Secretary may prescribe), a written explanation with respect to the qualified preretirement survivor annuity comparable to that required under subparagraph (A).

"(ii) APPLICABLE PERIOD.—For purposes of clause (i), the term 'applicable period' means, with respect to a participant, whichever of the following periods ends last:

"(I) The period beginning with the first day of the plan year in which the participant attains age 32 and ending with the close of the plan year preceding the plan year in which the participant attains age 35.

"(II) A reasonable period after the individual becomes a participant.

"(III) A reasonable period ending after paragraph (5) ceases to apply to the participant.

"(IV) A reasonable period ending after section 401(a)(11) applies to the participant.

"(V) A reasonable period after separation from service in case of a participant who separates before attaining age 35."

(B) AMENDMENT OF ERISA.—Subparagraph (B) of section 205(c)(3) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(B)(i) Each plan shall provide to each participant, within the applicable period with respect to such participant (and consistent with such regulations as the Secretary may prescribe), a written explanation with respect to the qualified preretirement survivor annuity comparable to that required under subparagraph (A).

"(ii) For purposes of clause (i), the term 'applicable period' means, with respect to a participant, whichever of the following periods ends last:

"(I) The period beginning with the first day of the plan year in which the participant attains age 32 and ending with the close of the plan year preceding the plan year in which the participant attains age 35.

"(II) A reasonable period after the individual becomes a participant.

"(III) A reasonable period ending after paragraph (5) ceases to apply to the participant.

"(IV) A reasonable period ending after section 401(a)(11) applies to the participant.

"(V) A reasonable period after separation from service in case of a participant who separates before attaining age 35."

(6) SPOUSAL CONSENT FOR CHANGES IN DESIGNATIONS.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Subparagraph (A) of section 417(a)(2) (relating to requirement that spouse consent to election) is amended to read as follows:

"(A)(i) the spouse of the participant consents in writing to such election, (ii) such election designates a beneficiary (or a form of benefits) which may not be changed without spousal consent (or the consent of the spouse expressly permits designations by the participant without any requirement of further consent by the spouse), and (iii) the spouse's consent acknowledges the effect of such election and is witnessed by a plan representative or a notary public, or".

(B) AMENDMENT OF ERISA.—Subparagraph (A) of section 205(c)(2) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(A)(i) the spouse of the participant consents in writing to such election, (ii) such election designates a beneficiary (or a form of benefits) which may not be changed without spousal consent (or the consent of the spouse expressly permits designations by the participant without any requirement of further consent by the spouse), and (iii) the spouse's consent acknowledges the effect of such election and is witnessed by a plan representative or a notary public, or".

(C) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to plan years beginning after the date of the enactment of this Act.

(7) CLARIFICATION OF NONFORFEITABLE ACCRUED BENEFIT.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Subclause (I) of section 401(a)(11)(B)(iii) is amended by striking out "the participant's nonforfeitable accrued benefit" and inserting in lieu thereof "the participant's nonforfeitable accrued benefit (reduced by any security interest held by the plan by reason of a loan outstanding to such participant)".

(B) AMENDMENT OF ERISA.—Subparagraph (C) of section 205(b)(1) of the Employee Retirement Income Security Act of 1974 is amended by striking out "the participant's nonforfeitable accrued benefit" and inserting in lieu thereof "the participant's nonforfeitable accrued benefit (reduced by any

security interest held by the plan by reason of a loan outstanding to such participant)".

(8) CLARIFICATION OF DEFINITION OF VESTED PARTICIPANT.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Paragraph (1) of section 417(f) (defining vested participant) is amended by striking out "the accrued benefit derived from employer contributions" and inserting in lieu thereof "such participant's accrued benefit".

(B) AMENDMENT OF ERISA.—Paragraph (1) of section 205(h) of the Employee Retirement Income Security Act of 1974 is amended by striking out "the accrued benefit derived from employer contributions" and inserting in lieu thereof "such participant's accrued benefit".

(9) CLARIFICATION OF QUALIFIED PRERETIREMENT SURVIVOR ANNUITY.—

(A) AMENDMENTS OF INTERNAL REVENUE CODE.—

(i) Paragraph (2) of section 417(c) (defining qualified preretirement survivor annuity) is amended by striking out "the account balance of the participant as of the date of death" and inserting in lieu thereof "the portion of the account balance of the participant (as of the date of death) to which the participant had a nonforfeitable right (within the meaning of section 411(a))".

(ii) Subsection (c) of section 417 (defining qualified preretirement survivor annuity) is amended by adding at the end thereof the following new paragraph:

"(3) SECURITY INTERESTS TAKEN INTO ACCOUNT.—For purposes of paragraphs (1) and (2), any security interest held by the plan by reason of a loan outstanding to the participant shall be taken into account in determining the amount of the qualified preretirement survivor annuity."

(B) AMENDMENTS OF ERISA.—

(i) Paragraph (2) of section 205(e) of the Employee Retirement Income Security Act of 1974 is amended by striking out "the account balance of the participant as of the date of death" and inserting in lieu thereof "the portion of the account balance of the participant (as of the date of death) to which the participant had a nonforfeitable accrued benefit".

(ii) Subsection (e) of section 205 of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(3) For purposes of paragraphs (1) and (2), any security interest held by the plan by reason of a loan outstanding to the participant shall be taken into account in determining the amount of the qualified preretirement survivor annuity."

(10) CLARIFICATION OF REQUIREMENTS FOR SPOUSAL CONSENT.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Subsection (f) of section 417 (as amended by paragraph (4)) is amended by redesignating paragraph (6) as paragraph (7) and by inserting after paragraph (5) the following new paragraph:

"(6) REQUIREMENTS FOR CERTAIN SPOUSAL CONSENTS.--No consent of a spouse shall be effective for purposes of subsection (e)(1) or (e)(2) (as the case may be) unless requirements comparable to the requirements for spousal consent to an election under subsection (a)(1)(A) are met."

(B) AMENDMENT TO ERISA.—Section 205 of the Employee Retirement Income Security Act of 1974 (as amended by paragraph (4)) is amended by redesignating subsection (k) as subsection (l) and by inserting after subsection (j) the following new subsection:

"(k) No consent of a spouse shall be effective for purposes of subsection (g)(1) or (g)(2) (as the case may be) unless requirements comparable to the requirements for spousal consent to an election under subsection (c)(1)(A) are met."

(11) CLARIFICATION OF RULE FOR SUBSIDIZED PLANS.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Subparagraph (A) of section 417(a)(5) (as redesignated by paragraph (4)(A)) is amended by striking out "if the plan" and inserting in lieu thereof "if such benefit may not be waived (or another beneficiary selected) and if the plan".

(B) AMENDMENT TO ERISA.—Subparagraph (A) of section 205(c)(5) of the Employee Retirement Income Security Act of 1974 (as redesignated by paragraph (4)(B)) is amended by striking out "if the plan" and inserting in lieu thereof "if such benefit may not be waived (or another beneficiary selected) and if the plan".

(12) CLARIFICATION OF ANNUITY STARTING DATE.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Paragraph (2) of section 417(f) (defining annuity starting date) is amended to read as follows:

"(2) ANNUITY STARTING DATE.—

"(A) IN GENERAL.—The term 'annuity starting date' means—

"(i) the first day of the first period for which an amount is payable as an annuity, or

"(ii) in the case of a benefit not payable in the form of an annuity, the first day on which all events have occurred which entitle the participant to such benefit.

"(B) SPECIAL RULE FOR DISABILITY BENEFITS.—For purposes of subparagraph (A), the first day of the first period for which a benefit is to be received by reason of disability shall be treated as the annuity starting date only if such benefit is not an auxiliary benefit."

(B) AMENDMENT TO ERISA.—Paragraph (2) of section 205(h) of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(2)(A) The term 'annuity starting date' means—

"(i) the first day of the first period for which an amount is payable as an annuity, or

"(ii) in the case of a benefit not payable in the form of an annuity, the first day on which all events have occurred which entitle the participant to such benefit.

"(B) For purposes of subparagraph (A), the first day of the first period for which a benefit is to be received by

reason of disability shall be treated as the annuity starting date only if such benefit is not an auxiliary benefit."

(13) Clarification of plans to which requirements apply.—

(A) Amendment to internal revenue code.—Subclause (I) of section 401(a)(11)(B)(iii) is amended by striking out "section 417(a)(2)(A)" and inserting in lieu thereof "section 417(a)(2)".

(B) Amendment to ERISA.—Clause (i) of section 205(b)(1)(C) of the Employee Retirement Income Security Act of 1974 is amended by striking out "subsection (c)(2)(A)" and inserting in lieu thereof "subsection (c)(2)".

(14) Certain plans do not need to provide certain survivor benefits.—

(A) Amendment to internal revenue code.—Paragraph (11) of section 401(a) is amended by redesignating subparagraph (D) as subparagraph (E) and by inserting after subparagraph (C) the following new subparagraph:

"(D) Special rule where participant and spouse married less than 1 year.—A plan shall not be treated as failing to meet the requirements of subparagraphs (B)(iii) or (C) merely because the plan provides that benefits will not be payable to the surviving spouse of the participant unless the participant and such spouse had been married throughout the 1-year period ending on the earlier of the participant's annuity starting date or the date of the participant's death."

(B) Amendment to ERISA.—Section 205(b) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(3) A plan shall not be treated as failing to meet the requirements of paragraph (1)(C) or (2) merely because the plan provides that benefits will not be payable to the surviving spouse of the participant unless the participant and such spouse had been married throughout the 1-year period ending on the earlier of the participant's annuity starting date or the date of the participant's death."

(15) Clerical amendments.—

(A) Paragraph (1) of section 417(a) is amended by striking out "section 401(a)(ii)" and inserting in lieu thereof "section 401(a)(11)".

(B) Paragraph (1) of section 417(c) is amended by striking out "survivor annuity or the life of" in the matter preceding subparagraph (A) and inserting in lieu thereof "survivor annuity for the life of".

(C) Subparagraph (B) of section 415(b)(2) is amended by striking out "as defined in section 401(a)(11)(G)(iii)" and inserting in lieu thereof "as defined in section 417".

(c) Amendments Related to Sections 104 and 204 of the Act.—

(1) Treatment of qualified domestic relations orders for individuals other than spouse or former spouse.—

(A) In general.—Paragraph (9) of section 402(a) (relating to alternate payee under qualified domestic relations order

treated as distributee) is amended by striking out "the alternate payee shall be treated" and inserting in lieu thereof "any alternate payee who is the spouse or former spouse of the participant shall be treated".

(B) CONFORMING AMENDMENT.—Section 72(m)(10) (relating to determination of investment in the contract in the case of qualified domestic relations orders) is amended by inserting "who is the spouse or former spouse of the participant" after "alternate payee".

(C) EFFECTIVE DATE.—The amendments made by this paragraph shall apply to payments made after the date of the enactment of this Act.

(2) PROCEDURES FOR PERIOD DURING WHICH DETERMINATION IS BEING MADE.—

(A) AMENDMENTS OF THE INTERNAL REVENUE CODE.—

(i) Subparagraph (A) of section 414(p)(7) (relating to procedures for period during which determination is being made) is amended by striking out "shall segregate in a separate account in the plan or in an escrow account the amounts" and inserting in lieu thereof "shall separately account for the amounts (hereinafter in this paragraph referred to as the 'segregated amounts')".

(ii) Subparagraph (B) of section 414(p)(7) (relating to payment to alternate payee if order is determined to be qualified domestic relations order) is amended—

(I) by striking out "18 months" and inserting in lieu thereof "the 18-month period described in subparagraph (E)", and

(II) by striking out "plus any interest" and inserting in lieu thereof "including any interest".

(iii) Subparagraph (C) of section 414(p)(7) is amended—

(I) by striking out "18 months" and inserting in lieu thereof "the 18-month period described in subparagraph (E)", and

(II) by striking out "plus any interest" and inserting in lieu thereof "including any interest".

(iv) Subparagraph (D) of section 414(p)(7) is amended by striking out "the 18-month period" and inserting in lieu thereof "the 18-month period described in subparagraph (E)".

(v) Paragraph (7) of section 414(p) is amended by adding at the end thereof the following new subparagraph:

"(E) DETERMINATION OF 18-MONTH PERIOD.—For purposes of this paragraph, the 18-month period described in this subparagraph is the 18-month period beginning with the date on which the first payment would be required to be made under the domestic relations order."

(B) AMENDMENTS OF ERISA.—

(i) Clause (i) of section 206(d)(3)(H) of the Employee Retirement Income Security Act of 1974 is amended by striking out "shall segregate in a separate account in

the plan or in an escrow account the amounts" and inserting in lieu thereof "shall separately account for the amounts (hereinafter in this subparagraph referred to as the 'segregated amounts')".

(ii) Clause (ii) of section 206(d)(3)(H) of such Act is amended—

(I) by striking out "18 months" and inserting in lieu thereof "the 18-month period described in clause (v)", and

(II) by striking out "plus any interest" and inserting in lieu thereof "including any interest".

(iii) Clause (iii) of section 206(d)(3)(H) of such Act is amended—

(I) by striking out "18 months" and inserting in lieu thereof "the 18-month period described in clause (v)", and

(II) by striking out "plus any interest" and inserting in lieu thereof "including any interest".

(iv) Clause (iv) of section 206(d)(3)(H) of such Act is amended by striking out "the 18-month period" and inserting in lieu thereof "the 18-month period described in clause (v)".

(v) Subparagraph (H) of section 206(d)(3) of such Act is amended by adding at the end thereof the following new clause:

"(v) For purposes of this subparagraph, the 18-month period described in this clause is the 18-month period beginning with the date on which the first payment would be required to be made under the domestic relations order."

(3) COORDINATION WITH QUALIFIED PLAN REQUIREMENTS.—Section 401 is amended by redesignating the subsection relating to cross references as subsection (n) and by inserting after subsection (l) the following new subsection:

"(m) COORDINATION WITH QUALIFIED DOMESTIC RELATIONS ORDERS.—The Secretary shall prescribe such rules or regulations as may be necessary to coordinate the requirements of subsection (a)(13)(B) and section 414(p) (and the regulations issued by the Secretary of Labor thereunder) with the other provisions of this chapter."

(4) CLARIFICATION OF APPLICATION OF DOMESTIC RELATION PROVISIONS.—

(A) AMENDMENT OF INTERNAL REVENUE CODE.—Subsection (p) of section 414 is amended by redesignating paragraph (9) as paragraph (11) and by inserting after paragraph (8) the following new paragraph:

"(9) SUBSECTION NOT TO APPLY TO PLANS TO WHICH SECTION 401(a)(13) DOES NOT APPLY.—This subsection shall not apply to any plan to which section 401(a)(13) does not apply."

(B) AMENDMENT OF ERISA.—Paragraph (3) of section 206(d) of the Employee Retirement Income Security Act of 1974 is amended by redesignating subparagraph (L) as subparagraph (N) and by inserting after subparagraph (K) the following new subparagraph:

"(L) This paragraph shall not apply to any plan to which paragraph (1) does not apply."

(5) BENEFIT PAYMENTS MADE IN ACCORDANCE WITH QUALIFIED DOMESTIC RELATIONS ORDERS NOT TREATED AS GARNISHMENTS FOR PURPOSES OF CONSUMER CREDIT PROTECTION ACT.—Paragraph (3) of section 206(d) of the Employee Retirement Income Security Act of 1974 (as amended by paragraph (4)(B)) is further amended by inserting after subparagraph (L) the following new subparagraph:

"(M) Payment of benefits by a pension plan in accordance with the applicable requirements of a qualified domestic relations order shall not be treated as garnishment for purposes of section 303(a) of the Consumer Credit Protection Act.".

(6) TREATMENT OF CERTAIN SPOUSES.—

(A) AMENDMENT OF THE INTERNAL REVENUE CODE.—Subparagraph (A) of section 414(p)(5) (relating to treatment of former spouse as surviving spouse for purposes of determining survivor benefits) is amended by striking out "sections 401(a)(11) and 417" and inserting in lieu thereof "sections 401(a)(11) and 417 (and any spouse of the participant shall not be treated as a spouse of the participant for such purposes)".

(B) AMENDMENT OF ERISA.—Clause (i) of section 206(d)(3)(F) of the Employee Retirement Income Security Act of 1974 is amended by striking out "section 205" and inserting in lieu thereof "section 205 (and any spouse of the participant shall not be treated as a spouse of the participant for such purposes)".

(7) CLERICAL AMENDMENTS.—

(A) AMENDMENTS OF INTERNAL REVENUE CODE.—

(i) Subparagraph (F) of section 402(a)(6) is amended by striking out "paragraph (5)(A)" and inserting in lieu thereof "paragraph (5)".

(ii) Clause (i) of section 414(p)(1)(B) is amended by striking out "to a spouse," and inserting in lieu thereof "to a spouse, former spouse,".

(iii) Clause (i) of section 414(p)(6)(A) is amended by striking out "any other alternate payee" and inserting in lieu thereof "each alternate payee".

(iv) Subparagraph (B) of section 414(p)(5) is amended by striking out "the surviving spouse" and inserting in lieu thereof "the surviving former spouse".

(v) Subsection (p) of section 414 is amended by striking out the last sentence of paragraph (5) and by inserting after paragraph (9) the following new paragraph:

"(10) WAIVER OF CERTAIN DISTRIBUTION REQUIREMENTS.—With respect to the requirements of subsections (a) and (k) of section 401 and section 409(d), a plan shall not be treated as failing to meet such requirements solely by reason of payments to an alternative payee pursuant to a qualified domestic relations order."

(vi) Paragraph (4)(A) of section 414(p) is amended—

(I) by striking out "In the case of any payment before a participant has separated from service, a" and inserting in lieu thereof "A", and

(II) by inserting "in the case of any payment before a participant has separated from service," before "on or" in clause (i).

(vii) Subparagraph (B) of section 414(p)(4) is amended to read as follows:

"(B) EARLIEST RETIREMENT AGE.—For purposes of this paragraph, the term 'earliest retirement age' means earlier of—

"(i) in the date on which the participant is entitled to a distribution under the plan, or

"(ii) in the later of—

"(I) the date the participant attains age 50, or

"(II) the earliest date on which the participant could begin receiving benefits under the plan if the participant separated from service."

(B) AMENDMENTS OF ERISA.—

(i) Clause (ii) of section 206(d)(3)(F) of the Employee Retirement Income Security Act of 1974 is amended by striking out "the former spouse" and inserting in lieu thereof "the surviving former spouse".

(ii) Subclause (I) of section 206(d)(3)(G)(i) of such Act is amended by striking out "any other alternate payee" and inserting in lieu thereof "each alternate payee".

(iii) Subparagraph (E) of section 206(d)(3) of such Act is amended—

(I) by striking out "In the case of any payment before a participant has separated from service, a" in clause (i) and inserting in lieu thereof "A", and

(II) by inserting "in the case of any payment before a participant has separated from service," before "on or" in subclause (I).

(iv) Clause (ii) of section 206(d)(3)(E) of such Act is amended to read as follows:

"(ii) For purposes of this subparagraph, the term 'earliest retirement age' means the earlier of—

"(I) the date on which the participant is entitled to a distribution under the plan, or

"(II) the later of the date of the participant attains age 50 or the earliest date on which the participant could begin receiving under the plan if the participant separated from service."

(d) AMENDMENTS RELATED TO SECTIONS 105 AND 205 OF THE ACT.—

(1) VESTED ACCRUED BENEFIT.—

(A) AMENDMENTS TO THE INTERNAL REVENUE CODE.—

(i) Subparagraph (A) of section 411(a)(11) (relating to restrictions on certain mandatory distributions) is amended to read as follows:

"(A) IN GENERAL.—If the present value of any vested accrued benefit exceeds $3,500, a plan meets the requirements of this paragraph only if such plan provides that such ben-

efit may not be immediately distributed without the consent of the participant."

(ii) Subsection (a) of section 411 is amended by striking out "paragraphs (1) and (2)" in the matter preceding paragraph (1) and inserting in lieu thereof "paragraphs (1), (2), and (11)".

(B) AMENDMENTS TO ERISA.—Paragraph (1) of section 203 of the Employee Retirement Income Security Act of 1974 is amended to read as follows:

"(1) If the present value of any vested accrued benefit exceeds $3,500, a pension plan shall provide that such benefit may not be immediately distributed without the consent of the participant."

(2) DISTRIBUTIONS UNDER SECTION 404(k).—

(A) AMENDMENT TO THE INTERNAL REVENUE CODE.—Section 411(a)(11) is amended by adding at the end thereof the following new subparagraph:

"(C) DIVIDEND DISTRIBUTIONS OF ESOPS ARRANGEMENT.—This paragraph shall not apply to any distribution of dividends to which section 404(k) applies."

(B) AMENDMENT TO ERISA.—Section 203(e) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(3) This subsection shall not apply to any distribution of dividends to which section 404(k) of the Internal Revenue Code of 1954 applies."

(e) AMENDMENTS RELATED TO SECTION 207 OF THE ACT.—

(1) Paragraph (1) of section 402(f) (relating to written explanation to recipients of distributions eligible for rollover treatment) is amended by striking out "qualifying rollover distribution" and inserting in lieu thereof "eligible rollover distribution".

(2) Paragraph (2) of section 402(f) is amended to read as follows:

"(2) DEFINITIONS.—For purposes of this subsection—

"(A) ELIGIBLE ROLLOVER DISTRIBUTION.—The term 'eligible rollover distribution' means any distribution any portion of which may be excluded from gross income under subsection (a)(5) of this section or subsection (a)(4) of section 403 if transferred to an eligible retirement plan in accordance with the requirements of such subsection.

"(B) ELIGIBLE RETIREMENT PLAN.—The term 'eligible retirement plan' has the meaning given such term by subsection (a)(5)(E)(iv)."

(f) AMENDMENT RELATED TO SECTION 301 OF THE ACT.—

(1) SPECIAL RULE FOR ESOPS.—

(A) AMENDMENT TO THE INTERNAL REVENUE CODE.—Section 411(d)(6) is amended by adding at the end thereof the following new subparagraph:

"(C) SPECIAL RULE FOR ESOPS.—For purposes of this paragraph, any—

"(i) tax credit employee stock ownership plan (as defined in section 409(a)), or

"(ii) employee stock ownership plan (as defined in section 4975(e)(7)),

shall not be treated as failing to meet the requirements of this paragraph merely because it modifies distribution options in a nondiscriminatory manner."

(B) AMENDMENT TO ERISA.—Section 204(g) of the Employee Retirement Income Security Act of 1974 is amended by adding at the end thereof the following new paragraph:

"(3) For purposes of this subsection, any—

"(A) tax credit employee stock ownership plan (as defined in section 409(a) of the Internal Revenue Code of 1954), or

"(B) employee stock ownership plan (as defined in section 4975(e)(7) of such Code),

shall not be treated as failing to meet the requirements of this subsection merely because it modifies distribution options in a nondiscriminatory manner."

(2) CLERICAL AMENDMENT.—Paragraph (1) of section 204(g) of the Employee Retirement Income Security Act of 1974 is amended by striking out "section 302(c)(8)" and inserting in lieu thereof "section 302(c)(8) or 4281".

(g) AMENDMENT RELATED TO SECTION 302 OF THE ACT.—Paragraph (2) of section 302(b) of the Retirement Equity Act of 1984 is amended by striking out "January 1, 1987" and inserting in lieu thereof "July 1, 1988".

(h) AMENDMENTS RELATED TO SECTION 303 OF THE ACT.—

(1)(A) Subsection (c) of section 303 of the Retirement Equity Act of 1984 (relating to transitional rule for requirement of joint and survivor annuity and preretirement survivor annuity) is amended by adding at the end thereof the following new paragraph:

"(4) ELIMINATION OF DOUBLE DEATH BENEFITS.—

"(A) IN GENERAL.—In the case of a participant described in paragraph (2), death benefits (other than a qualified joint and survivor annuity or a qualified preretirement survivor annuity) payable to any beneficiary shall be reduced by the amount payable to the surviving spouse of such participant by reason of paragraph (2). The reduction under the preceding sentence shall be made on the basis of the respective present values (as of the date of the participant's death) of such death benefits and the amount so payable to the surviving spouse.

"(B) SPOUSE MAY WAIVE PROVISIONS OF PARAGRAPH (2).—In the case of any participant described in paragraph (2), the surviving spouse of such participant may waive the provisions of paragraph (2). Such waiver shall be made on or before the close of the second plan year to which the amendments made by section 103 of this Act apply. Such a waiver shall not be treated as a transfer of property for purposes of chapter 12 of the Internal Revenue Code of 1954 and shall not be treated as an assignment or alienation for purposes of section 401(a)(13) of the Internal Revenue Code of 1954 or section 206(d) of the Employee Retirement Income Security Act of 1974."

(B) Section 2503 is amended by adding at the end thereof the following new subsection:

"(f) Waiver of Certain Pension Rights.—If any individual waives, before the death of a participant, any survivor benefit, or right to such benefit, under section 401(a)(11) or 417, such waiver shall not be treated as a transfer of property by gift for purposes of this chapter."

(2) Subparagraph (A) of section 303(e)(2) of the Retirement Equity Act of 1984 (relating to treatment of certain participants who perform services on or after January 1, 1976) is amended by striking out "in the first plan year" and inserting in lieu thereof "in any plan year".

(3) Paragraph (2) of section 303(c) of the Retirement Equity Act is amended by adding at the end thereof the following new sentence: "In the case of a profit-sharing or stock bonus plan to which this paragraph applies, the plan shall be treated as meeting the requirements of the amendments made by sections 103 and 203 with respect to any participant if the plan made a distribution in a form other than a life annuity to the surviving spouse of the participant of such participant's nonforfeitable benefit."

(i) Technical Amendment to Section 408(d) of ERISA.—

(1) Subsection (d) of section 408 of the Employee Retirement Income Security Act of 1974 is amended by striking out "(a),".

(2) The amendment made by paragraph (1) shall apply to transactions after the date of the enactment of this Act.

(j) Effective Date.—Except as otherwise provided in this section, any amendment made by this section shall take effect as if included in the provision of the Retirement Equity Act of 1984 to which such amendment relates.

CHAPTER 3—AMENDMENT RELATED TO THE CHILD SUPPORT ENFORCEMENT AMENDMENTS OF 1984

SEC. 1899. AMENDMENT RELATED TO THE CHILD SUPPORT ENFORCEMENT AMENDMENTS OF 1984.

(a) In General.—Section 457(b)(3) of the Social Security Act is amended by inserting "or administrative" after "court".

(b) Effective Date.—The amendment made by this section shall become effective on the date of the enactment of this Act.

CHAPTER 4—MISCELLANEOUS AMENDMENTS CORRECTING ERRORS OF SPELLING, PUNCTUATION, ETC.

SEC. 1899A. MISCELLANEOUS AMENDMENTS CORRECTING ERRORS OF SPELLING, PUNCTUATION, ETC.

(1) Paragraph (4) of section 25(f) is amended by striking out "insure" and inserting in lieu thereof "ensure".

(2) Subparagraph (A) of section 103(h)(2) (relating to prohibition of discrimination) is amended by striking out "guaranted" and inserting in lieu thereof "guaranteed".

(3) Subparagraph (B) of section 103(m)(3) (relating to exceptions) is amended by striking out "section 608(6)(A)" and inserting in lieu thereof "section 608(a)(6)(A)"

(4) Paragraph (4) of section 103(p) is amended by striking out "October" and all that follows and inserting in lieu thereof "October 27, 1949 (48 U.S.C. 1403)."

(5) Clause (i) of section 132(h)(3)(B) (defining qualified automobile demonstration use) is amended by striking out "such use in" and inserting in lieu thereof "such use is".

(6) Paragraph (6) of section 172(d) is amended by inserting "MODIFICATIONS RELATED TO REAL ESTATE INVESTMENT TRUSTS.—" after "(6)".

(7) Clause (i) of section 338(h)(3)(C) is amended by striking out "subparagraph (A) and (B)" and inserting in lieu thereof "subparagraphs (A) and (B)".

(8) Paragraph (12) of section 341(e) is amended by striking out "1245(a).—" in the heading and inserting in lieu thereof "1245(a), ETC.—".

(9) Clause (iii) of section 374(e)(1)(A) is amended by striking out "Court of Claims" and inserting in lieu thereof "United States Claims Court".

(10) Paragraph (22) of section 401(a) is amended by striking out "if" and inserting in lieu thereof "If".

(11) Subsection (d) of section 409 is amended by striking out "participants's" and inserting in lieu thereof "participant's".

(12) Subparagraph (B) of section 414(p)(3) is amended by striking out the comma after "benefits".

(13) Subsection (k) of section 415 is amended to read as follows:

"(k) DEFINITIONS OF DEFINED CONTRIBUTION PLAN AND DEFINED BENEFIT PLAN.—For purposes of this title, the term 'defined contribution plan' or 'defined benefit plan' means a defined contribution plan (within the meaning of section 414(i)) or a defined benefit plan (within the meaning of section 414(j)), whichever applies, which is—

"(1) a plan described in section 401(a) which includes a trust which is exempt from tax under section 501(a),

"(2) an annuity plan described in section 403(a),

"(3) an annuity contract described in section 403(b),

"(4) an individual retirement account described in section 408(a),

"(5) an individual retirement annuity described in section 408(b), or

"(6) a simplified employee pension."

(14) Clause (ii) of section 468(d)(2)(B) is amended by striking out "Comprehensive Environmental, Compensation, and Liability Act of 1980" and inserting in lieu thereof "Comprehensive Environmental Response, Compensation, and Liability Act of 1980".

(15) Clause (i) of section 501(c)(1)(A) is amended by striking out "the date of the enactment of the Tax Reform Act of 1984" and inserting in lieu thereof "July 18, 1984".

(16) Paragraph (2) of section 505(c) is amended by striking out "the date of the enactment of the Tax Reform Act of 1984" and inserting in lieu thereof "July 18, 1984".

(17) Clause (i) of section 535(b)(5)(C) and subparagraph (C) of section 535(b)(8) are each amended by striking out "the date of the enactment of the Tax Reform Act of 1984" and inserting in lieu thereof "July 18, 1984".

(18) Subparagraph (B) of section 543(a)(1) is amended by striking out "46 U.S.C." and inserting in lieu thereof "46 U.S.C App.".

(19) The second sentence of section 751(c) is amended by striking out "section 617(f)(2), stock" and inserting in lieu thereof "section 617(f)(2)), stock".

(20) Subsection (a) of section 844 is amended by striking our "prior law),, unused loss" and inserting in lieu thereof "prior law), unused loss".

(21) Paragraph (2) of section 864(c) is amended by striking out "section 871(h) section 881(a)" and inserting in lieu thereof "section 871(h), section 881(a)".

(22) Subparagraph (A) of section 881(b)(2) is amended by striking out "Paragraph" and inserting in lieu thereof "paragraph".

(23) Subparagraph (C) of section 881(c)(3) is amended by striking out "section 864(d)(4)." and inserting in lieu thereof "section 864(d)(4))."

(24) The paragraph heading of section 904(d)(1) is amended to read as follows:

"(1) IN GENERAL.—".

(25) Paragraphs (23), (24), (25), and (26) of section 1016(a) are each amended by striking out the comma at the end thereof and inserting in lieu thereof a semicolon.

(26) Subsection (c) of section 1042 is amended by striking out "this section.—" in the material preceding paragraph (1) and inseting in lieu thereof "this section—".

(27) Paragraphs (1) and (2) of section 1060 are each amended by striking out "46 U.S.C." and inserting in lieu thereof "46 U.S.C. App.".

(28) Subsection (e) of section 1276 is amended by striking out "the date of the enactment of this section" and inserting in lieu thereof "July 18, 1984".

(29) Subparagraph (C) of section 1277(b)(1) is amended by striking out "this paragaph" and inserting in lieu thereof "this paragraph".

(30) The heading for subparagraph (C) of section 1277(b)(2) is amended by striking out "PARAGRAPH 1.—". and inserting in lieu thereof "PARAGRAPH (1).—".

(31) Subsection (d) of section 1277 is amended by striking out "the date of the enactment of this section" and inserting in lieu thereof "July 18, 1984".

(32) Paragraph (4) of section 1278(a) is amended by striking out "means of" and inserting in lieu thereof "means".

(33) Paragraph (1) of section 1371(e) is amended by inserting "(within the meaning of section 1368(e))" after "accumulated adjustments account".

(34) Paragraph (2) of section 1371(e) is amended by striking out "(within the meaning of section 1368(e))".

(35) Paragraph (2)(A) of section 1504(c) is amended by striking out "subsection (b)(2) includes" and inserting in lieu thereof "subsection (b)(2)) includes".

(36) Subsection (c) of section 1551 is amended by striking out "section 269(b)" and inserting in lieu thereof "section 269(c)".

(37) Subsection (d) of section 2210 is amended by striking out "may prescibe" and inserting in lieu thereof "may prescribe".

(38) Clause (ii) of section 3121(v)(2)(A) is amended by striking out "forefeiture" and inserting in lieu thereof "forfeiture".

(39) The first sentence of paragraph (1) of section 3121(w) is amended by striking out "chapter 21 of this Code" and inserting in lieu thereof "this chapter".

(40) Paragraph (2) of section 3121(w) is amended by striking out "the date of the enactment of this subsection" and inserting in lieu thereof "July 18, 1984".

(41) Subsection (e) of section 3231 is amended by redesignating the paragraph (6) added by Public Law 98–612 as paragraph (7).

(42) Paragraph (1) of section 3301 is amended by striking out "unemployed" and inserting in lieu thereof "unemployment".

(43) Clause (iii) of section 3304(a)(6)(A) is amended by striking out "and" at the end thereof.

(44) Subparagraph (A) of section 3306(b)(2) is amended by striking out "workman's compensation" and inserting in lieu thereof "workmen's compensation".

(45) Paragraph (13) of section 3306(b) is amended by striking out the comma at the end thereof and inserting in lieu thereof a semicolon.

(46) The heading for paragraph (6) of section 3406(b) is amended by striking out "6041(A)(a)" and inserting in lieu thereof "6041A(a)".

(47) Paragraph (1) of section 4051(d) is amended by striking out "the date of the enactment of the Tax Reform Act of 1984" and inserting in lieu thereof "July 18, 1984".

(48) Clause (ii) of section 4161(b)(1)(B) is amended by striking out the period at the end thereof and inserting in lieu thereof a comma.

(49) Section 4227 is amended to read as follows:

"SEC. 4227. CROSS REFERENCE.

> ***"For exception for a sale to an Indian tribal government (or its subdivision) for the exclusive use of an Indian tribal government (or its subdivision), see section 7871.***

(50) The heading for paragraph (1) of section 4961(c) is amended by striking out "COURT OF CLAIMS" and inserting in lieu thereof "UNITED STATES CLAIMS COURT".

(51) The second sentence of subsection (d) of section 4975 is amended by striking out "and (12) shall not" and inserting in lieu thereof "and (12)) shall not".

(52) Subsection (f) of section 6011 is amended by striking out "sections 6012 to 6019, inclusive" and inserting in lieu thereof "subparts B and C".

(53) Clause (v) of section 6103(l)(7)(D) is amended by striking out "this Code" and inserting in lieu thereof "this title".

(54) Subparagraph (B) of section 6111(d)(1) is amended by striking out "subpargraph" and inserting in lieu thereof "subparagraph".

(55) Paragraph (1) of section 6427(b) is amended by striking out "provided in paragraph (2)" and inserting in lieu thereof "otherwise provided in this subsection".

(56) Paragraph (1) of section 6427(g) is amended by striking out "anount" and inserting in lieu thereof "amount".

(57) The heading for section 6660 is amended by striking out "THE ESTATE" and inserting in lieu thereof "ESTATE".

(58) Subparagraph (B) of section 7422(g)(1) is amended by striking out "section 4962" and inserting in lieu thereof "section 4963".

(59) Paragraph (1) of section 7476(c) is amended by striking out "plan,, or" and inserting in lieu thereof "plan, or".

(60) Subparagraph (E) of section 7482(b)(1) is amended by striking out "partnership," and inserting in lieu thereof "partnership.".

(61) Subsection (i) of section 7611 is amended—

(A) by redesignating subparagraphs (A), (B), (C), (D), and (E) as paragraphs (1), (2), (3), (4), and (5), respectively.

(B) by striking out "etc)," in paragraph (3) (as so redesignated) and inserting in lieu thereof "etc.),", and

(C) by striking out "the title" in paragraph (5) (as so redesignated) and inserting in lieu thereof "the title".

(62) Paragraph (1) of section 7611(a) is amended by striking out all that follows subparagraph (A) and inserting in lieu thereof the following:

"(B) the notice requirements of paragraph (3), have been met."

(63) Clause (i) of section 7701(b)(4)(E) is amended by striking out "preceeding" and inserting in lieu thereof "preceding".

(64) Paragraph (5) of section 7701(e) is amended by striking out "section 168(C)(2)(F))" and inserting in lieu thereof "section 168(c)(2)(F))".

(65) Subparagraph (F) of section 7871(a)(6) is amended by striking out the period at the end thereof and inserting in lieu thereof "; and".

(66) Paragraph (2) of section 101(b) of the Tax Reform Act of 1984 is amended by inserting "(as such paragraphs (4) and (5) are amended by this section and section 102)" after "(4), and (5)".

(67) Subparagraph (C) of section 102(e)(3) of the Tax Reform Act of 1984 is amended by striking out "paragraph (7)(A) (including the heading)" and inserting in lieu thereof "paragraphs (6)(B) and (7)(A) (including any headings)".

(68) Paragraph (1) of section 127(b) of the Tax Reform Act of 1984 is amended by inserting "(as amended by section 128)" after "subsection (c)".

(69) Subparagraph (A) of section 221(d)(2) of the Tax Reform Act of 1984 is amended by striking out "rapid that" and inserting in lieu thereof "rapid than".

(70) The item relating to tax credit employee stock ownership plans in the table of sections for subpart A of part I of subchapter D of chapter 1 is amended to read as follows:

"Sec. 409. Qualifications for tax credit employee stock ownership plans."

(71) The table of sections for subpart C of part II of subchapter E of chapter 1 is amended in the item relating to section 467 by inserting "the" before "use".

(72) The table of subparts for part V of subchapter P of chapter 1 is amended by inserting "on bonds" after "discount" in the item relating to subpart B.

(73) The table of sections for subchapter B of chapter 3 is amended by striking out the item relating to section 1461 and inserting in lieu thereof the following:

"Sec. 1461. Liability for withheld tax."

(74) The table of sections for subchapter G of chapter 32 is amended by striking out "references" in the item relating to section 4227 and inserting in lieu thereof "reference".

(75) The table of sections for chapter 43 is amended by—

(A) inserting "section" before "403(b)" in the item relating to section 4973, and

(B) striking out "and allocations" in the item relating to section 4978.

And the Senate agree to the same.

DAN ROSTENKOWSKI,
J.J. PICKLE,
CHARLES B. RANGEL,
PETE STARK,
RICHARD A. GEPHARDT,
MARTY RUSSO,
DONALD J. PEASE,
JOHN J. DUNCAN,
GUY VANDER JAGT,
Managers on the Part of the House.

BOB PACKWOOD,
BOB DOLE,
JOHN H. CHAFEE,
RUSSELL B. LONG,
LLOYD BENTSEN,
SPARK M. MATSUNAGA,
BILL BRADLEY
DANIEL PATRICK MOYNIHAN,
Managers on the Part of the Senate.

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